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FOREIGN BANKING SYSTEMS

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CONTENTS

FOREIGN BANKING SYSTEMS

CHAPTER I

INTRODUCTION:

BANKING DEVELOPMENT 1918–1928

BY H. PARKER WILLIS [1]

The future economic historian will undoubtedly assign to the war and the financial changes which followed it as great an influence upon banking and credit as upon money. In so doing, he will direct special attention to the decade from 1918 to 1928, recognizing that during those ten years the forces which had been set in motion in the course of the struggle itself had taken definite shape, and had thus placed themselves in position to be more or less accurately appraised. He will admit that the changes in banking and credit thus referred to were at the outset regarded as purely temporary and casual, probably to be gradually overcome as the monetary systems of the world were " stabilized " or " restored to normal "; but he will none the less note that, with the passage of years, practically all observers had become convinced, however reluctantly, that these changes were by no means transitory, and that they had in fact become quite definitely recognizable as structural or permanent alterations, within two or three years after the close of the war.

GREAT CHANGES IN BANKING. Believing that the decade in question has drawn the outlines of a decidedly new financial and banking map of the world, and recognizing that what has been done during the decade will be the foundation upon which a much larger structure will be reared in the future, the student of human institutions, and especially the student of finance, must be at pains to ascertain the more fundamental of the alterations which have thus occurred, to classify them carefully, and to appraise so far as may be, their significance for the future. In order to accomplish that result, he will find it essential to review with care the actual modifications of law and practice which took place in the

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banking systems of the principal countries during the period in question, and he will regard such survey as the essential foundation upon which to base all general conclusions and interpretations.

European Experience Significant. In making such a survey, attention is naturally first of all directed to European countries, partly because they were the actual scene of the war itself and of the fundamental changes in economic and social life which grew out of it. But when this survey has once been made, the thought of the student is inevitably further extended, to other groups of countries, since he immediately recognizes the fact that banking changes of a reflected sort, in many cases quite as important and as far-reaching as those which took place in the theatre of war, have been produced as the result of the fluidity of capital and the close interrelationship between markets which were already recognized in pre-war financial structures. And finally, he will come to the conclusion not only that, in practically all countries, the whole trend of financial development has been greatly altered by the war, but that it has been altered in a way which runs roughly parallel in the several countries. He will thus probably form the opinion that the developments of the decade were equivalent to fundamental changes of trend and purpose, and that at no time was it possible by any process to restore or reinstitute exactly the banking and credit conditions which had existed before the opening of the World War.

Accepting this brief analysis of the significance of banking and credit study from the standpoint of the present moment, the question may be definitely considered: What are these fundamental and general changes that have taken place in banking and credit organization throughout the world in general, during the ten years under discussion?

Social Significance of Banking. Probably the most broadly important of such changes is the alteration in the current view of the basic significance of banking and of the place of banking, — of the whole credit operation, — in the economic and social life of the world. Before the war, the prevailing thought of professional economists appeared to be that banking and credit were more or less mechanical phenomena whose purpose was little more than that of facilitating the exchange of goods; — a function important

in itself, fundamentally significant indeed, yet by no means possessing the importance in the study of economics as a science which would normally be ascribed to studies of distribution, of value and of institutional economics. There were not a few who expressed a feeling that the discussion of the subjects had already been carried so far that they were worn out or worked out, and that future elaboration of them would lie, practically wholly, along the lines of technique and procedure. There would, in this view of the case, thought these reasoners, be large opportunity in the future for the work of the "financial expert" or credit organizer, yet comparatively little, probably, for the theorist in banking, money, credit, or even in the field of prices. The latter field of study, indeed, was regarded as having received definitive, if not final, treatment.

Alterations in Theory. The change which has come about as a result of World War transformations has overturned all of this hasty and rather self-satisfied thinking. Its most significant alteration is one of point of view. The banking question of the present day is undoubtedly recognized by all careful students as being fundamentally a question of social organization and control; its immediate significance chiefly found in its effect upon the distribution of wealth; its ultimate significance found in connection with the bearing it has upon production and in its power to direct production into new and different channels. Only approximately and incidentally, has its exchange function a broad significance at the moment, for it is recognized that this exchange function, whatever it may be in different countries, is primarily controlled and established both in its operation and in its significance, by the effect produced by banking and credit arrangements upon distribution and production. Thinking of banking and credit in this way, current economic reasoners are disposed to view the banking and credit question with its ancillary issues in the field of prices as perhaps the most fundamental of current economic problems. The unrest produced by fluctuating prices, the broad transformations of social structure produced by repudiation either total or partial, the changes in productive power brought about by rising or declining price levels with their reflex influence upon business activity, and the great alterations in the relationship of social classes growing out of the abolition of older

groups of property-holders and their transformation into wage-earners, have served to illustrate and to confirm the belief which has been arrived at through general observation. So we may today take it for granted that the study of banking and credit, and of money as an auxiliary thereto, is to be viewed as one of those underlying and essential discussions in fundamental economics which cannot be definitely relegated to any one part of the field of economic doctrine or theory but which must be regarded as pervading the whole system of thought and as conditioning it in nearly all of its connotations.

Reorganization of Topic. With this altered outlook upon the whole field, it has been inevitable that there should be a corresponding alteration of outlook upon the different subfields within the general tract of inquiry. No only has the economist a totally new view of the money and credit function of society, but in accepting this altered point of view he has found it necessary to readjust his thought of the relationship between the three subfields to which for want of better terms we may attach the familiar labels money, credit, and banking. Not a few of the older writers on these topics had fallen quite definitely into the habit of dealing chiefly with the theory of money, and, having made out to their own satisfaction a logical system of thought on that subject, were then disposed to deal with credit and banking as ways of rendering money more " efficient " or of providing " substitutes " for money. Indeed, so deeply had this notion become rooted that there were many, and indeed there still survive some, who had adopted the practice of speaking of checks, drafts, and bills of exchange as " money substitutes," ignoring the fact that it was entirely possible to conceive of an organization of exchange which would operate entirely without money in use, and might operate without reference to any standard of money in the ordinary sense of the term.

Results of Observation. The change in point of view with respect to this matter has been produced, first of all, as the result of observation. The war drove money out of use in many countries; yet left them with a more or less workable system of producing, distributing, and exchanging goods. We are now in the throes of an effort to return to the gold standard, and in so doing we encounter not only the practical, but also the theoretic, oppo-

sition of some who believe that such a return is not necessary and that a system of " managed " currency might be substituted for it. At the same time, we encounter many who are quite as firmly of the opinion that the gold standard, whatever its merits, will be satisfactory only if checked and controlled by some process of stabilizing prices, other than the oft-proposed project of altering the amount of such money either coined or perhaps produced at the mines. In short, we have practically reached a stage in which many economists are willing to admit that banking, credit and money are three distinct groups of phenomena, closely interrelated it is true but by no means identical or even directly dependent the one upon the other, — certainly not governed by identical principles.

Need of Separate Treatment of Sub-Fields. This in itself is a great advance toward the working out of a satisfactory and consistent general theory which will cover relations between all three groups. It must not be assumed that there are known laws of interdependence which govern all three fields, but the principles which are valid in each must be carefully evolved and individually studied. Acceptance of this point of view has immensely simplified and clarified the whole discussion of banking. It has freed us, for example, from the thought that there is some necessary relationship between the volume of bank reserves, or of money in circulation, and the volume of bank deposits; from the fallacious thought that a bank could expand its credit only at a fixed ratio, since any further expansion beyond that would result in drawing off its cash to a dangerous extent. It has also greatly transformed the attitude adopted toward the use of note currency, for most observers have at length clearly perceived that such note currency was in no respect different from bank credit.

Effect of " Fiat Credit." The recognition that World War finance contributed to human financial experience the phenomenon of " fiat credit " has done much toward spreading the recognition of the truth that credit created in this way has the same effect, and brings on the same dangers, as fiat currency. In many other directions, the altered way of approaching the subject of banking has simplified it by eliminating a large overlying structure of prejudice and of false assumption so that on the side of technique and of purely technical analysis, it has been possible to

get a point of view which in its way was quite as fresh and novel as that which has been developed through the change in attitude with respect to the social status of banking.

BANKING THE FUNDAMENTAL PROBLEM. It is, however, to the field of banking, and to that primarily, that the present volume addresses itself, and it is with that field, therefore, that this introductory chapter is alone concerned. Viewing banking then for the moment as a phenomenon isolated from the allied fields of credit and of money, we may begin by saying that the effect of World War experience has undoubtedly been, first of all, to compel admission of the view that banking is an economic function in whose general management and direction the community at large is profoundly interested and whose effects cannot be escaped by any member or any class. That being the case, there has almost inevitably been developed a public interest in banking institutions and laws and a disposition to regard banking as a kind of public service enterprise which was non-existent or rudimentary prior to the World War. It is quite true that before the war we had in some countries a superabundance of interference with banking. To this fact the multitudinous national and state statutes of our own country bear ample witness. These, however, represented an attitude quite different from the one which exists today.

THE COMMUNITY POINT OF VIEW. It was an attitude of repression or regulation, whereas at the present moment the community point of view toward banking appears to be fundamentally that of direction or management; — a change which is both significant and dangerous, inasmuch as the new interest in banking undoubtedly increases the likelihood of a community direction that may be applied in undesirable or hazardous ways. Be this as it may, the altered point of view as regards the community's interest in the subject is leading, whether we like it or not, to completely altered legislative attitudes and codes and also to greatly transformed portfolios in banks themselves. It is undoubtedly leading to an extension of banking methods and influence, too, that had not been previously contemplated, and would in older days undoubtedly have been regarded as unwise. In surveying this field of post-war treatment of banking, we may to advantage note first of all some outstanding examples of the trend

toward government ownership, direction or control; — a trend which is unmistakably more striking and compelling than any other element in the present day situation, and in that connection to consider first of all the development of that trend in the field of central banking.

Central Banking and Its Status. One of the most spectacular developments in both banking doctrine and banking practice which has occurred since the war has been furnished by the new attitude that has been adopted with respect to central banking. Before the war central banking was recognized in most countries as a desirable type of banking organization. Many of the advanced commercial countries had central banks of their own, and in nearly all cases these central banks were in some way affiliated with the government so that they acted as fiscal agents, receiving and disbursing taxes, advancing funds to their governments on short term, and otherwise addressing themselves to the task of smoothing the relationship between the public treasury and business. At the same time, they exerted a headship over the money market, undertook to regulate the flow of specie into and out of the country, and endeavored more or less to control local rates of interest and discount.

How important these functions actually were the student of banking is well aware. At the same moment, he also recognizes that there was abundant opinion in pre-war economic circles to the effect that central banking method was open to very grave criticism at the time, and that there was at least a fair ground of argument for the view that some other method of organizing the banking system of a nation would be preferable. In the United States the resistance to central banking had for years past been sufficient to prevent any serious proposal of the sort from making its appearance in Congress, while in Canada both economists and bankers frankly expressed the opinion that nothing in the way of a central bank was needed. The Commonwealth Bank of Australia had been established against the violent protests of local bankers in that country, and was far from conducting itself as a regular central bank. In still other countries, the scope and functions of central banks were doubtful, and there was continuous controversy as to the question how far such banks ought to be allowed to go in taking on new business.

Post-War Attitude. The post-war period has brought a great change in all these particulars. It has not only broadened the number of central banks and banking institutions, but it has also increased their scope. Only a few years after the war the Genoa conference of the League of Nations, after discussion of the entire banking situation, recommended in 1922, the establishment of a central bank by each of the newly-created states of Europe and recommended that such central banks should stand in close relationship to the governments of the countries in which they were located. This advice has not been altogether generally accepted, but it has undoubtedly had a very powerful effect upon opinion, while on the other hand the general belief in centralization, and the tendency to concentrate government functions in a small number of hands had already laid the foundation for the growth of centralization in banking. Not only has this been true, but it has also been necessary for the different countries to have a very considerable amount of banking assistance in connection with the funding of their debts, the placing of new loans and other operations of the same kind, while the financial weakness of most of them has made them closely dependent upon the money market. A result of all these factors has been found in the growing tendency to establish and rely upon the aid of central banks with large powers. How far this movement has gone may be understood from the following brief enumeration of the principal central banks of the world as grouped by the Federal Reserve System, with the dates of their establishment, from which it will appear that a very substantial percentage of these institutions has come into being, or have been remodeled with much larger authority, since the opening of the World War:

Bank of Sweden	1656	National Bank of Greece	1842
Bank of England	1694	Bank of Italy	1859
Bank of France	1800	German Reichsbank	1875
Bank of Finland	1809	National Bank of Rumania	1880
Netherlands Bank	1814	Bank of Japan	1882
Bank of Norway	1816	National Bank of Serbia	1883
Austrian National Bank	1817	National Bank of Bulgaria	1885
National Bank of Denmark	1818	Bank of Uruguay	1896
Bank of Portugal	1821	National Bank of Egypt	1898
Bank of Java	1828	Swiss National Bank	1905
Bank of Spain	1829	Czechoslovak National Bank	1920
National Bank of Belgium	1835	S. African Reserve Bank	1920

Bank of Latvia 1922	Bank of Poland 1924
Bank of Lithuania 1922	National Bank of Hungary . 1924
Reserve Bank of Peru 1922	Central Bank of Chile 1925
State Bank of Russia 1922	Bank of Esthonia 1927
Bank of Danzig 1924	

Permanence of New Attitude. The mere creation of central banks and the establishment of an intimate relationship between them and the government might, however, be regarded as a rather transitory phenomenon, likely to fade a good deal in importance as the various governments emerge from their difficulties, and as their progress toward a normal and stable condition of affairs economically and financially speaking, becomes better and better marked. Obviously such a course of development may yet be witnessed, but the great expansion of central banking since the close of the war has a much deeper root than that which is furnished by the temporary necessities of the various governments in the handling of their debts or their post-war tax problems. The war experience with fiat credit and with movements of prices undoubtedly had a very powerful influence in confirming many in the opinion that a central bank should be at hand as a mechanism for controlling and directing movements of prices, for forcing other (non-central) banks to accept the orders of the government, and to coöperate with it in carrying out its projects, and for controlling the money market situation on behalf of government operations. It has thus come about that the advocacy of central banking and the effort to enlarge its breadth and powers has taken shape as a " social " movement. It is too technical, of course, to appeal to a more than comparatively limited public, but the rank and file of citizens give it their indirect support by the constant demands which they make upon government authorities for subventions and assistance of one kind or another, either to individuals, to corporations or to causes and movements.

Demand for " Credits." In all such cases, the request is made that banking aid be invoked or provided, for the purpose of establishing " credits " in favor of this, that or the other enterprise. The machinery of central banking is set at work to render such action possible, and in not a few cases the argument is offered that higher or lower discount rates should be established, or that this that or the other central banking policy should be adopted for the

purpose of improving business, shifting prices, or "evening-up" the relationships between social classes. Of course this kind of urgency implies a fairly extensive shift in the basis of belief regarding the influence of credit upon prices and business. But with the war example before the different communities, they have come to believe strongly, in some cases blindly, in the efficacy of credit as a "business builder." There is undoubtedly a very large, if still unformed, school of popular thinkers who are of the opinion that changes in the volume of credit can undoubtedly bring about immediate changes in the volume of trade and can in that way produce either prosperity or depression. It is through such waves of popular belief, no matter whether well or ill founded, that great changes in economic institutions are produced, and in this case the influence of such opinions upon the development of the central banking idea is proving a factor of first significance.

Maintenance of Central Institutions. It is already apparent that the result of what has been accomplished during and since the war in the way of central bank expansion must undoubtedly be to maintain for a long time the group of central institutions which, by reason of the powers that they have assumed or have been granted to them, will be able to direct and in some cases to hamper the development of banking as practiced by privately owned institutions. The strength of the movement may eventually decline, but for the present purpose it is sufficient to note that no such decline is in prospect, but that on the contrary an important effect of the war is seen in the steady and continuous upward trend in the activities, powers and influence of central banks and in their operations as representative of the governments which have established them. This must, during the period of its activity, result in a materially altered type of banking organization and operation throughout the world.

Government control of commercial banking had, as already noted, before the war taken largely the form of government interference or regulation, as illustrated in the multifarious acts of legislation to which reference has already been made. It has been natural that with the war over and a great deal of reorganization to be effected in all directions, the idea of a largely extended control of banking should have made its way to the front and should gradually have crystallized into proposals for the nationalization,

and in some cases complete ownership, of central banks by the governments of the countries in which they were established. Today, we have a large school of thought in many countries of the world which regards government ownership or at least government direction, as the natural and inevitable outcome of our present conditions.

THE NATIONALIZATION MOVEMENT. Already, at the beginning of the war, the nationalization movement (which had made considerable headway in the United States under the leadership of a variety of "radical" thinkers) had led to compromises in the establishment of the Federal Reserve System whereby a very large element of government control had been admitted into that organization. The success both of the Federal Reserve System and of the Bank of England during the war, in raising money for the conduct of the struggle, impressed many minds with the thought that the machinery of credit should not be allowed to get out of hand by returning to purely private control. Accordingly, since the war, the unmistakable trend of affairs in nearly all countries has been toward the active participation of government in, and even the ownership, not only of central banks and their branches, but in most countries toward the extension of government participation into other banking fields. No doubt the most extreme illustration of this drift was afforded in Russia where the period of communism with its rejection of banking and money as capitalistic instrumentalities was succeeded by a régime in which it was sought to use both as government agencies in the service of the community. As a result there has been set up in the Soviet Republic not only a state bank wholly controlled by the government and invested with the duty of regulating and directing credit and currency, but a variety of other banks whose duty it appears to be to perform industrial services for the different branches of business to which they are credited or assigned. It is too soon by far to form an opinion as to the probable success of this project. The details of its working, the problems it has to meet are fully set forth in the section of this book which has been assigned to Russia. It is enough at this point to cite the Russian situation as an illustration, on the extreme left it is true, but still an illustration, of an important drift in modern banking management. Not so far removed from it may be mentioned the state

institutions which have either been set up or converted to public use in such countries as Czechoslovakia, Austria and others.

Control of Note Currency. In most such cases the alleged reason for the nationalization of central banking has been the control of the note currency and through it of foreign exchange — the stabilization, in short, of financial relationships between the country in question and others. Yet closer examination shows that, whether intentionally or otherwise, such enumeration of functions is incomplete; and that, in most instances, a more or less deliberate attempt to control price levels by restricting or enlarging the supply of credit, and to direct the operations of other banks by determining their access to the central organization, has been instituted. In the financially stronger countries of the Western world, and in the United States, this tendency has been very much more attenuated. Yet it is true, none the less, that there has been a long march toward nationalization even in those countries which seem furthest from it. The Federal Reserve System has taken on many duties, and has exercised many functions, which without the war would certainly have been denied to it, and even in England it is today proposed to revise the bank act in such a way as to bring about a degree at least of real nationalization.

Reasons for Demand for Aid. The reasons for such nationalization are not usually frankly stated. In a good many cases, the apparent ground for taking the step is the disposition to obtain a more intimate association between the central bank and the national government with reference to the management of public finance. The war has, of course, left most countries in a position which is very dependent upon banks and banking credit for actual financial existence, since practically all of them have found difficulty in balancing their budgets and have been obliged to depend upon their central banks for a means of approaching the money market not only for temporary balances required to cover deficits, but also for the means which are essential to refunding, redeeming and redistributing the actual obligations representing their outstanding indebtedness. A survey of banking operations in a few of the principal countries indicates the extraordinary dependence upon short term loans which still exists in nearly all of them. While it might be entirely possible, under

favorable conditions, to get all the aid that was necessary in connection with the management of such obligations, conditions are not always favorable. Moreover, the frequency with which resort to the money market has become necessary has brought it about that a large share of the business of most central banking institutions now has to do with government finance and its readjustment and rearrangement.

Control of Central Banks. Accordingly a close control of central banks appears to government administrators to be a wise step as well as a measure of economy. It is not strange, therefore, that in a good many countries, somewhat the same conditions that existed during the later part of the war or immediately after it have persisted, and that, as a result of such persistence, they have come to be regarded as more less necessary and even semi-permanent. The progressive nationalization of central banks is a natural outgrowth of this situation, and has been observable in nearly all countries as these nations have found it impossible to work out of the mire of indebtedness at any early date, and hence have had to accustom themselves to continuous government financing and government banking control.

Experience Abroad. A survey of experience in some principal countries will illustrate this statement. The United States, for example, instead of refunding its debt into long term bonds, has chosen to convert short-term maturities as they fell due into obligations of but little longer duration. Large issues of debt have been renewed on a five-year basis from time to time, while constant borrowing and reborrowing in the form of short-term certificates has been necessary. The result has been a very large turnover at reserve banks, in government business exclusively. As a consequence of this situation, there has been steady tinkering on the part of the Treasury department with the discount rate, in the effort to keep it low, and hence to facilitate the floating of new Treasury obligations, while there has been equally steady effort on the part of the Treasury to control and direct the actual policy of reserve banks. Very similar conditions have prevailed in some of the European countries. The reorganization of the Reichsbank that followed the revision of the Reparations programme in 1924, was largely founded upon the notion of close government oversight and control of that institution, such con-

trol being partly that of the German Government itself, but also in an important degree the control originating with outside governments which desired to use the Reichsbank as an instrumentality in facilitating settlement of the reparations debt.

Other Precedents. Experience has shown that a very large share of the work of the Reichsbank has been concerned with this sort of international debt adjustment. In France, the making of short-term loans to the Treasury, and the refunding of debt occupies a large share of the attention of the Bank of France, while its portfolio of Government obligations, amounting to not less than 30,000,000,000 francs, represents fully six times its entire private transactions as represented by loans and discounts. The government has not assumed any such direct share of the control of the Bank of England. Yet it remains true that that Bank has been obliged to give itself very largely to the transaction of Government business, and that a large part of its turnover has consisted of such business, while its rate policy and other features of its transactions have been primarily shaped with a view to facilitating the affairs of the Treasury rather than those of the commercial world. This situation may be best illustrated by making a comparison of the pre-war and present statements of a few of the principal European banks, with a view of comparing the changes that have taken place in certain essential items. The figures so given have a direct bearing on the point now under consideration because they reflect the relative change in the importance of public business as compared with other that has taken place during the period in question. They also have an important bearing on other kindred considerations which will be discussed a little later in this chapter.

Alterations of Policy. Several important alterations in central banking policy have grown out of this drift towards nationalization. Probably the most striking is the one already incidentally referred to in the foregoing discussion, — the movement in favor of a central control of note issues. It must be remembered, of course, that before the war there was already a decided demand for the abrogation of the private bank-note issues in a good many countries. England had, long years before the war, provided by law for the gradual consolidation of the note issue power in the hands of the Bank of England, as individual banks possess-

ing the right of issue were consolidated with others or gave up their privilege. In France, note issue had for a long time been recognized as a part of the monopoly of the Bank of France. In Germany, the bank reorganization which took place after the formation of the Empire had copied English practice by providing for the gradual resumption of the note issue power in favor of the Reichsbank as the individual German banks gradually gave it up. There were other instances of like sort. Nevertheless, it remained true that the world was very evenly divided on this subject. In the United States, up to the formation of the Federal Reserve System, there was little indication of intent to abrogate the privilege of issue by individual banks; (and it may parenthetically be added that, notwithstanding provisions made in the Federal Reserve Act for terminating the issue privileges of the national banks, they have been a dead letter, there being today as many national banknotes in circulation as there were in 1913.) In Canada, a vigorous and flourishing bank-note issue system prevailed, indeed has maintained itself from that day to this. In other English dominions, the issue privilege remained quite generally in the hands of individual banks, and the same is true in a variety of minor independent countries both of Europe and of South America. The widespread practice of private issue in the Orient continued unabated. But the post-war period has brought many changes.

War Confirms Note Tendencies. It may fairly be said that the war tended to confirm the conception of note issue which had already begun to make headway and to anchor the note issue power firmly in the central banks of the world as a quasi-governmental or public-service undertaking. The fact that most of the central banking legislation that has been adopted during or since the war has tended strongly toward the concentration of the note issue power and the recognition of it as a semi-governmental matter is illustrated by the war amendments to the Federal Reserve Act, by the reorganization of the Reichsbank after the inflation period, and by the charters of the newer state or government banks which have been either created afresh, or remodeled, or rebuilt out of previously existing fragments. In consequence, it is not too much to say that the war and the post-war conditions have tended powerfully to confirm a belief in

centralization of note issue, which had already become firmly established, and which had definitely borne fruit even before the war in the form of measures tending to consolidate the note issue function in many countries.

Effects of Note Centralization Obscure. Just what precise effect the accentuation of the note centralization movement which has taken place during the past ten years has had, cannot therefore be as dogmatically stated as is possible in the case of some of the other tendencies that have made themselves manifest since the close of the war. Some of the major trends in the situation may however be, at least tentatively, set forth. First of all, partly as a result of necessity and partly in consequence of renewed belief in government power of creating money standards, there is a quite evident drift in the direction of uniting the government issue function with that of banking; or, what is the same thing, of making the future bank notes obligations or liabilities of the government, or at all events issues in which the government feels a strong sense of responsibility. The tendency thus indicated is of far greater importance than appears on the surface.

The Note Monopoly. The fact that most, if not all, of the new Federal banks or banking institutions, in the new states established subsequent to the close of the war, have taken over the note issue privilege as a monopoly and evidently expect to continue it on this basis reflects the change in theory which has led most writers on banking now to speak of note issue as essentially a function belonging to the state and as such properly to be exercised by it. It is true that, in most cases, they express the opinion that the older methods of note-issue, involving issues of fiat money, were disastrous, and adhere to the view that note issue in the modern period should be effected through a bank on banking principles solely. Nevertheless, the tendency to commandeer the mechanism of central banks in the interest of public finance, taken in conjunction with the drift already mentioned toward making the function of note issue an exclusive monopoly of the state or of a central bank owned by the state, suggests what has too often proved to be the case — the use of the note issue as an agency of public finance and the regulation of the volume of notes with a view to controlling exchange quotations, or in some cases domestic prices, or both. Stated in another way, this merely

amounts to a suggestion that the older conception of note issue, which viewed the bank note as the outgrowth of a business transaction and considered that it should come into existence in order to facilitate the making of such transactions, has been largely lost to sight. The more recent theory on the subject, whether sound or otherwise, is quite evidently that of leaving the check and deposit system as the only flexible and automatically expanding agency of credit, while taking over the note issue as an element or factor in government operation of central banking, — not even leaving it to be used at discretion (as was the case with some central banks before the war), in the interest of business. It is today, more and more, an agency which has been and is being employed for the purpose of performing what are called "social" functions; — by which is meant the application of governmental power to banking enterprise and to banking instrumentalities, for the purpose of facilitating government borrowing and control of the value of money in exchange for commodities both at home and abroad.

Consequent Changes of View. The fact that this great change in attitude, diverting a tendency already antedating the war into a new post-war channel and use, has become definitely established, almost necessitates in itself the introduction of other changes of somewhat similar significance. One of these is a progressive movement toward concentration of banking interests and of banking control. Like the centralization of the note issue power in the hands of a single bank, that tendency was observable prior to the coming of the war. In the United States it had already led to a demand for corrective legislation which ultimately produced the so-called Clayton Act (in its banking sections, prohibiting interlocking directorates, at all events.) In England the concentration movement had already considerably lessened the number of institutions, but war conditions greatly accelerated the tendency toward reduction, and it was not long after the struggle was over before the well known report on bank amalgamations called sharp attention to the drift of things. This was followed by the agreement informally entered into by England's principal banks wherein they undertook to carry through no further combination, and to make no change that would result in reducing the number of institutions, without obtaining the as-

sent of the Treasury. But before this agreement had been arrived at, English banks had been reduced to 25 in number and of this small group nearly a score were of comparatively small capitalization, the bulk of the resources being in the hands of the "Big Five." Concentration had also proceeded very fast on the Continent and the weakness resulting from the war eliminated many of the multitudinous German institutions which had previously flourished throughout the Empire. In France, the number of incorporated banks had been small for a good many years, but post-war developments greatly reduced the number of private banking houses, while this movement was later paralleled in Latin countries. In Canada, the number of chartered banks fell from 30 at the opening of the century to about 20 at the beginning of the war and 10 at the present time. The so-called merger movement was later in getting started in the United States but became greatly accelerated after 1919 with the result that at the present time some 250–350 mergers per annum are occurring. Bank merger tendencies in the United States afford a reflection of the concentration movement in some of the more important countries and so further emphasize the drift toward a far more highly centralized condition among the commercial banks of the world.

Entrance to Banking More Difficult. It is undoubtedly more difficult today for individuals with small capital to embark upon the banking business even in those countries in which "free" banking is permitted, than has ever been the case in the past, and it is far more difficult for them to maintain themselves as going concerns subsequent to such establishment. A few reasons stand out conspicuously as the principal motivating factors in this situation. Chief among them, probably, is the great development of branch banking. The system is, of course, an old one which has been in process of development throughout many decades. Nevertheless, the technique of branch banking has been greatly altered as a result of quick methods of transportation and communication. Free use of the telegraph and telephone have brought branches into closer communication with the head office than ever before, and has rendered direct supervision more nearly feasible than in the past. The outcome has been a tendency to take on new commitments, and to open new offices, at points that otherwise would have been considered ineligible. Legislation fa-

vorable to branch banking has, on the whole, made good progress, although slowly. But every step forward in this connection has been followed by a corresponding expansion. Second in importance to the change in methods of banking thus outlined, has probably been the growth in the unit size of loans which has come as a result of the increasing magnitude of the business enterprise. The outcome of this growth in business demand for larger loans has been particularly visible in European countries where the increase in capitalistic combinations and the expansion of the cartel system have taken on renewed activity since the close of the war. It was out of the question to establish sufficiently highly-capitalized banks in the different localities to take care of these demands, and the result has of course been to resort to distant institutions. This change of practice has tended to increase the number of branches and at the same time to make the survival of small banks much more difficult.

Technical Banking Changes. Important technical changes in the position of banking have also taken place since the close of the war. The most striking of them is probably, broadly stated, an alteration in the degree of liquidity of the portfolios of the banks. Of course, it is practically never possible to express a definite judgment with respect to the degree of liquidity existing in any given banking institution, unless much more is known about the character of its assets than actually appears upon the surface. Whether a given item of bank paper is "liquid" or not, depends in large measure upon the market for that paper, or that security, as the case may be, and also upon the conditions under which the bank has acquired it. The older definition of liquidity, which was based upon a notion of "self-liquidation," is employed by but few banks at the present time, and in its complete former significance is perhaps not applicable to the organization of some existing institutions. But it remains true that a rough working idea of liquidity must be applied to the portfolio of any given bank to test the capacity of that institution for meeting its liabilities when they are presented for cashing. In a like way, the use of this same standard of liquidity at two varying dates affords a basis of comparison or contrast which alone could furnish a means of establishing judgment as to the relative position of the bank at the dates in question. Such standards of

liquidity may be, in some measure, developed from an outside study of the actual holdings of banks as reported by them to the public authorities to which they are responsible. Working on this basis, some inference may be drawn from comparative analysis of the bank statements prepared by a number of central institutions at dates before and after the war, and then from comparison of figures representing the condition of individual commercial banks in those same countries. We may begin with the portfolios of central banks as shown in tables [2] on pages 23 and 24.

Some Inferences. In a general way, the showing which is thus revealed indicates two conclusions: (1) an increase of large amount in the quantity of public or governmental paper carried, and (2) a general invasion of portfolios by paper obviously of long-term or of somewhat " frozen " character e.g. advances to the government. These two factors are the natural outgrowth of the general inability of business before and since the inflation period to resume the unquestionably liquid position which many concerns had occupied before the war. They have become more and more dependent upon their bankers for support, and in those circumstances have found it necessary, from time to time, to ask for renewals which in pre-war days probably would not have been granted to them. A very similar situation exists among American banks as is illustrated by the statement published by the Federal Reserve Board in its annual report published March 1927 as follows:

" The outstanding changes have thus been in the direction of a larger proportion of long term investments and of loans on securities and of a corresponding increase in the proportion of time deposits as compared with deposits payable on demand. . . . Of the total loans and investments of all member banks on June 30, 1926, 16% was eligible for rediscount at the reserve banks. . . . The decline in the proportion of eligible paper has been continuous and considerable. . . ."

The condition which is thus reflected among the banks of the United States undoubtedly exists in a much more marked degree among European banks, due to the fact that the European banks for the most part have found their clientèle far more affected by the war than has been true of American business houses. Both in

[2] From Federal Reserve Bulletin (figures currently carried each month).

Condition of Central Banks

[Figures are for the last report date of month]

	1927			1926
	October	September	August	October
Bank of England (millions of pounds sterling):				
Issue department —				
Gold coin and bullion	150.3	149.5	149.7	151.2
Notes issued	170.0	169.2	169.4	171.0
Banking department —				
Gold and silver coin	1.5	1.6	1.6	1.6
Bank notes	34.3	32.7	32.0	31.9
Government securities	40.7	56.3	58.4	36.7
Other securities	53.0	50.9	41.6	70.1
Public deposits	21.0	25.7	22.1	17.8
Other deposits	90.8	97.5	93.2	104.9
Ratio of gold and note reserve to deposit liabilities (percent)	32.0	27.9	29.0	27.4
Bank notes in circulation [3]	79.5	80.3	81.2	82.8
Currency notes and certificates	292.5	294.8	295.9	287.6
Bank of France (millions of francs):				
Gold reserve [4]	3,681	3,682	3,682	3,684
Silver reserve	343	343	343	339
Gold, silver, and foreign exchange	2,338	2,282	2,245	1,066
Credits abroad	56	58	53	80
Loans and discounts	3,296	3,567	3,357	7,494
Advances to the Government	24,850	24,400	25,050	35,750
Miscellaneous assets	24,080	23,733	23,965	5,062
Note circulation	54,700	54,156	52,672	54,578
Total deposits	10,786	10,439	12,524	3,981
German Reichsbank (millions of reichsmarks):				
Gold at home	1,785	1,786	1,786	1,536
Gold abroad	67	67	67	180
Reserves in foreign exchange	161	154	157	413
Bills of exchange and checks	2,802	2,746	2,662	1,415
Miscellaneous assets	571	494	480	631
Deposits	608	630	724	533
Reichsmarks in circulation	4,231	4,182	3,935	3,326
Rentenmarks in circulation	1,021	1,041	1,042	1,479

[3] Notes issued, less amounts held in banking department and in currency note account. [4] Not including gold held abroad.

Condition of Central Banks

[Figures are for the last report date of month]

	1927			1926
	October	September	August	October
Bank of Italy (millions of lire):				
Gold reserve	1,174	1,173	1,172	1,140
Credit and balances abroad	1,548	1,478	1,474	1,029
Loans and discounts	5,623	5,931	6,132	8,114
Advances to the Government	4,227	4,227	4,227	4,229
Note circulation for commerce	13,865	13,796	13,554	13,936
Note circulation for the State	4,227	4,127	4,227	4,229
Total deposits	3,187	3,422	3,322	2,788
Bank of Japan (millions of yen):				
Gold at home and abroad	1,063	1,063	1,063	1,058
Advances and discounts	927	903	933	366
Advances on foreign bills	15	5	3	48
Government bonds	159	167	167	280
Total note and deposit liabilities	2,291	2,306	2,345	1,935
Notes issued	1,320	1,163	1,210	1,288
Total deposits	972	1,142	1,136	647
Austrian National Bank (millions of schillings):				
Gold	84	84	84	48
Foreign bills of the reserve	389	392	393	492
Other foreign bills	251	245	221	135
Domestic bills	83	81	113	97
Treasury bills	173	173	173	178
Note circulation	953	946	939	890
Deposits	30	32	47	38
National Bank of Belgium (millions of belgas):				
Gold	684	674	658	559
Foreign bills and balances in gold	468	466	445	481
Domestic and foreign bills	519	505	471	459
Loans to State	400	400	400	400
Note circulation	1,998	1,996	1,926	1,753
Deposits	112	97	97	245

Europe and in America, it has continued to be a fact that banks in many cases have had to "nurse" weak commercial institutions, which, if pressed to make good their obligations, would have found it impossible to do so. The result has been a large number of frozen assets and an unfortunate situation which, in an increasing measure, has led to bank failures. This is illustrated by the remarkable failure record of the American banking system after 1920 which has been reviewed in recent studies.[5] While it is true that European banks have not suffered from any such failure situation owing to the fact that their structure, as well as governmental policy enabled them to resist it, it has nevertheless been a fact that considerable quantities of weak assets have developed, and have had to be absorbed by other banks, which, either under the appearance of merger or of purchase, have taken over the institutions that were in difficulty. This state of things has been particularly noteworthy in Canada. The effects of it are of course seen in the lessened liquidating power of the banks which have been obliged to absorb many less desirable assets.

STATUS OF COMMERCIAL PAPER. A general feature of post-war banking change that deserves consideration in this connection is seen in the altered status of commercial paper. Prior to the war, there had been an increasing tendency to admit to banks the paper of merchants with one or two names, preferably the latter number, — upon a pure credit basis. The war not only wrecked many concerns, but it also brought about a state of things in which banks began to exact security because of their uncertainty about the future foundations of commercial society. As a result, in nearly all European countries there has been a drift toward the use of secured paper as against unsecured or credit paper. This has taken form as a decline or decadence in the trade acceptance or ordinary bill of exchange, as well as in the use of the single-name note (which, however, had attained no such position in European banking prior to the war as it occupied in the United States). In lieu of the paper of merchants there has been a tendency to substitute obligations of banks, sometimes in the acceptance form, sometimes in the form of co-signer or endorser, while there has also been a growth of paper protected by collateral

[5] See e.g. *Hearings Before Senate Banking and Currency Committee, February*, 1926.

security. The credit status of the small and medium-sized enterprise has been greatly weakened; and, as a result, in a good many countries such enterprises have been prone to accept aid from private bankers or money-lenders who then raise the funds through a resort to banks upon their own credit. This tendency has emphasized a disposition to recapitalize enterprises in corporate form, and to give their stock or other obligations as security for their borrowings whether at banks or elsewhere. Co-operative borrowing has also made some progress because of the presumably greater safety which was thereby insured to the banks in consequence of the presence of several signatures or of a signature which represented several obligors. These tendencies have been particularly noteworthy in Germany and Austria, but they have also made their appearance in other European countries.

Altered Reserve Status. One of the changes in banking which has been most talked of since the close of the war, but whose results have probably been a good deal overestimated, is the vastly altered position with respect to reserve holdings,— which in this case means, in substance, gold holdings. The great changes in the distribution of gold, which have come about since the close of the war, are matters of commonplace, but rather less has been said with reference to the changes in the distribution of gold between central banks. These, however, have been very marked in two ways — the first, the actual changes in holdings of coin and bullion, the second, the relative changes as shown by reserve percentages in the holdings of such coin and bullion as compared with reserve deposits. It is the latter which is of chief interest, and which is therefore deserving of principal attention.

The background for these changes must, however, be found in the actual alterations in distribution of gold, and accordingly a brief sketch of this change in distribution may be furnished as on page 27.

Ownership of Gold. As thus set forth, very great alteration in the actual ownership of the gold of the world is at once perceived, the United States now being in possession of a preponderating share of the actually available metal. This change in ownership, however, does not show its distinct significance until it is understood what has taken place as regards the alteration in the

GOLD HOLDINGS OF CENTRAL BANKS AND GOVERNMENTS, 1913–1926

[In thousands of dollars, converted at par of exchange]

End of year —	Total	United States[6]	European countries (central banks)												
			Total	England[7]	France	Germany	Italy	Austria	Austria Hungary	Belgium	Bulgaria	Czechoslovakia	Denmark	Esthonia	Finland
1913	4,771,878	1,290,420	2,831,286	170,245	678,856	278,687	288,103	.....	251,421	59,131	10,615	......	19,666	.....	6,948
1914	5,251,177	1,184,369	3,483,769	428,221	802,591	498,508	299,759	.....	213,757	56,619	10,615	......	24,506	.....	6,229
1915	6,212,343	1,699,883	3,803,838	389,205	967,950	581,954	293,453	.....	138,750	50,759	11,773	......	29,833	.....	8,229
1916	6,478,426	2,185,139	3,503,234	402,970	652,885	599,873	255,772	.....	58,759	50,759	13,124	......	42,847	.....	8,229
1917	6,625,882	2,067,878	3,572,259	422,594	639,682	572,768	238,931	.....	53,717	50,759	12,159	......	46,611	.....	8,229
1918	6,270,779	2,169,778	3,081,519	523,632	664,017	538,861	243,566	.....	53,074	57,145	12,352	......	52,159	.....	8,229
1919	6,080,961	1,941,321	2,890,954	583,211	694,847	259,519	203,441	.....	45,011	51,417	7,141	......	60,807	.....	8,229
1920	6,616,922	1,933,809	3,034,214	762,912	689,517	260,028	204,362	.....	11	51,438	7,141	4,053	60,992	.....	8,229
1921	7,272,252	2,562,447	3,032,980	763,719	690,141	237,102	210,739	.....	16	51,451	7,334	12,545	61,192	.....	8,229
1922	8,289,759	3,504,283	3,043,514	751,597	708,403	227,436	217,284	.....	6	51,901	7,415	20,874	61,173	.....	8,371
1923	8,568,242	3,831,881	2,993,955	754,400	709,479	111,247	215,699	1,313	....	52,204	7,565	22,574	56,171	.....	8,242
1924	8,917,144	4,089,201	3,084,050	757,033	710,394	180,939	218,382	1,560	....	52,543	7,792	31,745	56,145	1,384	8,354
1925	8,913,018	3,984,659	3,136,630	703,482	710,968	287,763	218,825	2,087	....	52,855	7,981	30,575	56,085	1,279	8,357
1926	9,181,785	4,079,531	3,363,358	735,421	711,106	436,235	220,732	7,388	....	86,214	8,464	30,731	56,007	1,312	8,250

[6] Notes issued, less amounts held in banking department and in currency note account. [7] Not including gold held abroad.

banking position with respect to gold, a transformation which may be outlined for a few of the chief countries in the following brief table, which undertakes to state the gold position of banks in a number of leading countries as a percentage or " ratio " of outstanding demand liabilities, the latter figure being computed as the percentage of specie reserve (ratio of gold and gold exchange to notes and deposits). The figures given below are computed for the several countries on the basis of their statements (as of various dates in the years named):

Reserve Ratio of Central Banks

	1907	1927
Bank of England	51	29
Bank of France	72.5	27 [8]
Reichsbank	43	32
Natl. Bank of Belgium	15	30
Netherlands Bank	49	50
Swiss National Bank	65.74	50
Bank of Italy	40.2	12

New Gold Situation. Analyzed in this way the post-war gold situation becomes much more striking than it is when reflected in gross figures. Stated briefly in words, it amounts to a change whereby the majority of the banking systems of the world have assumed a demand responsibility which is far in excess of their capacity at pre-war ratios. This is merely another way of noting the great depreciations that have occurred in many currencies as compared with the pre-war levels of currency value. The difference between the two ways of stating things (i.e. as excessive growth of credit or as depreciation of standard) lies in the fact that the latter is the monetary point of view whereas the former represents the point of view of banking. It is the former in which we are chiefly interested, at the present moment. Looking at the situation from this point of view, it is evident that only a few of the banking systems of the world are in position to contemplate gold redemption in any early future, unless there should be a reduction in the value of their currency unit such as to bring about a readjusted relationship between gold on hand and their

[8] Reserve kept partly in foreign exchange; — slightly more than the specie.

[9] For all banks of issue. Note privilege now solely in hands of Bank of Italy.

outstanding deposit liabilities.[10] Even in the latter case, the question may well be asked whether they would be in position to make direct redemption and to maintain it, since balances of trade are in such a situation as to render doubtful the retention of the necessary gold even after such readjustment of relationships had taken place. It is precisely this problem with which England has been struggling in her effort to go back to the gold standard, and which is foreseen by every other country either in a similar situation or likely to be so, — from the international standpoint.

Monetary Problems in Background. We are not here concerned with the important monetary problems which grow out of the situation thus depicted but solely with the changes in banking method and purpose which have resulted from it. The financial characteristic of the post-war European world has been the difficulty which it has had to face in international indebtedness. This great burden of indebtedness has entailed upon the several countries the necessity of meeting in some way the danger of a continuous excess of imports over exports, or at all events a deficiency of exports, as a result of which they would have found it impossible to meet their obligations abroad. In every country, therefore, there has been a constant effort to stimulate the export trade, and to some extent at least to refrain from granting any stimulus to imports which might otherwise have been considered. This policy has been adopted because of the recognition that, as things stand, it would be easy to become heavily indebted in a way that would involve either gold exports or the necessity of providing gold from foreign sources, with corresponding expense and difficulty. Consequently, there has been a disposition, in all of the larger banks, to encourage exports by the advancing of funds to commercial borrowers, and at the same time so to manage the portfolio of the banks as to permit the comparatively easy acquisition of foreign exchange. Both factors are of sufficient importance to merit special attention.

Domestic vs. Foreign Trade. Prior to the war, the disposition of many bankers was to regard domestic trade as of higher

[10] Since the foregoing was written Italy and France have announced their acceptance of stabilization plans at "revalorized" rates for the monetary unit. Italy adheres to the gold exchange standard, France to the full gold basis, but even the latter country does not offer to redeem bank obligations directly in gold for any holder.

importance and to treat exporting as secondary. It was quite true that the best foreign bills had for many years been regarded as a peculiarly choice holding for banks, but the quantity of bills stated in foreign currency was always strictly limited, save in those countries which were working upon a gold-exchange standard, and even in those it was felt that the foreign portfolio required very special and careful treatment. The close of the war saw exceptional emphasis placed upon the necessity of stimulating exports; and, in many countries, including Great Britain, artificial aid of one sort or another was arranged for exporters. The British export credit scheme of 1919 furnishes an early post-war example while the large German bank credit negotiated in favor of Russia and guaranteed by the Government of Germany (1926) affords a much more recent instance of similar sort.

Aid to Exports. In other countries, the assistance given to exporting has been less obvious but nevertheless genuine. In most of the states of Europe which are on the gold exchange standard, there has been a recognized necessity for facilitating, so far as practicable, the export trade, since only in that way could be created the actual cash funds or claims required for use in remitting abroad the sums that were necessary in order to meet the indebtedness due in other countries. Consequently, not only at central banks but also at the rank and file of banking institutions in many such countries, there has been a general disposition to prefer industries that were engaged in producing for export. This situation has, of course, been emphasized by the fact that, in not a few such countries, export trade has been artificially financed, foreigners borrowing heavily either within the countries themselves or in other markets, and then spending the proceeds of their loans in large sums for the purpose of providing the goods that were needed for some extended public undertaking such as works of various kinds, railroad building, reconstruction of devastated regions, or even famine relief and the like. It is a somewhat remote index of this movement, but none the less a real one, that is furnished by the figures showing growth of external indebtedness of various countries since, as compared with a date before, the war. The following table gives a brief survey of such debts as incurred by a number of countries, and illustrates the sums which must be provided from some source for the purpose of meeting

outside demands. To get a true picture, of course, there must be an allowance representing foreign obligations held within the country, — for which however, figures are usually not available:

External Indebtedness of Various Countries

Belgium, September 30, 1927.	28,739,000,000 francs at current rates of exchange.
Denmark, March 31, 1926.	507,000,000 Kr.
France, August 31, 1927.	36,568,000,000 francs at par, divided as follows: Political 32,460,000,000 frs. Commercial 3,710,000,000 Railway 398,000,000
Germany, November 30, 1927.	903,000,000 R. M. (Dawes Loan only external obligation)
Great Britain, March 31, 1927.	£1,101,000
Italy, September 30, 1927.	U. S. Government $467,000,000 7% Loan due 1951 $ 97,000,000 British Government £ 86,800,000 [11]
Norway, December 31, 1926.	711,000,000 Kr. Probably slightly reduced during 1927, but figures not at hand.
Spain, December 31, 1926.	911,000,000 pesetas.
Sweden, October 31, 1927.	Total debt 1,817,000,000 Kr., of which about 20% is said to be held abroad.
Switzerland, December 31, 1926.	387,000,000 frs.

Financing Goods Movement. It is clear that with such great sums to remit abroad both absolutely and relatively speaking, the various countries must stand ready to finance the movement of the goods. Although such financing has, in not a few cases, been effected by investment banking methods, a great deal of the work has been done by commercial banks in the ordinary course of business, and the result has been a very great enlargement of the amount of foreign bills held in their portfolios. Contributory to this change in the composition of portfolios has naturally been, moreover, the steady expansion of the area which in one way or another has accepted the gold-exchange standard, making itself dependent upon some other market for the maintenance of its currency at parity, in theory, at least, with gold. Accordingly, there has been a necessity for providing exchange which could be regarded as available in such operations, and this exchange has furnished the basis for a still further enlargement of the port-

[11] Actual valuation on 5% basis of annuities agreed upon in the debt settlement.

folios of foreign bills so carried. It is unfortunately true that a good many banks do not furnish data designed to show the details concerning their foreign portfolios. Nevertheless, some figures bearing upon the situation can be presented as follows, changes in price level being borne in mind as a factor automatically producing the same effect:

FOREIGN ASSETS OF CERTAIN CENTRAL BANKS
(In millions)

Bank	*Unit*	*End of 1913*	*1928*	*Amount*
Sweden	Kr.	70	Dec. 31, 1927	87
Switzerland	Fr.	37	Jan. 31	63
Germany	Mk.	140	Jan. 31	296
				599 Sundry
Belgium	Fr.	167	Jan. 26	844
Netherlands	Fl.	19[12]	Jan. 30	183
				40 Divers
Denmark	Kr.	8	Jan. 31	0.5
France	Fr.	–	Feb. 2	[13]
Norway	Kr.	34	Nov. 30, 1927	41
Spain	Pes.	194	Jan. 28	41
Italy	Lire	14	Jan. 10	7,558

Relative Growth of Credit. The question may fairly be asked whether the tendency to enlarge the amount of credit going to export industries has correspondingly curtailed the amount going to domestic industries, and whether, therefore, the change in portfolio composition which is seen in enlargement of foreign bill holdings has been paralleled by a similar change representing a corresponding decline in domestic grants of credit. It would be difficult to pass finally upon this question without fuller and more complete data than are now at hand. What can be said with certainty is that there has been, as already stated, a very great enlargement in the amount of paper, both commercial and investment, growing out of foreign sales and transactions in nearly all countries. There has also been a great growth, in most countries, of the aggregate amount of credit granted by banks, and incidentally of the amount of credit granted to industries producing goods for domestic consumption. Merely absolute figures would throw but little light on the situation, and even com-

[12] March 31, 1914.

[13] Gold, silver and foreign exchange bought (Law 7/26) 2,412
Sundry 27,092
Free gold and gold assets abroad 463

parative figures are not especially instructive unless they can be accompanied by data designed to show the actual growth and needs of fundamental industries, and hence to afford information as to whether or not such industries have been somewhat retarded in order to provide capital and labor for the expansion of the export industries relied upon to supply the means of settling obligations. That there has been such a relative reduction in the amount of attention to domestic industries as compared with export, is fairly to be inferred from the data available. It remains true and unmistakable that relatively great expansion has taken place in the holdings of foreign bills, foreign acceptances and the like, which have come into the hands of most of the banking institutions of the European countries, as well as, indeed, those of the United States.

Central vs. Commercial Banking. A question which has received some little study although, it would seem, only in a sporadic way not connected with the changes in banking that have taken place since the close of the war, is afforded by the inter-relationship between central banking and commercial banking. The tendency here presented may be summarized in a statement that, in spite of the growing importance which has been assigned to central banking in post-war theorizing, it has been doubted whether the central banks themselves have been able to reëstablish that leadership of the market which they enjoyed prior to 1914, or indeed whether they will be able to reestablish it in any early future.

Perhaps the first serious attention given to this subject was concentrated upon it in Great Britain, in connection with the study of bank amalgamations which was conducted in 1920. The facts brought out in that inquiry showed, as we have already mentioned, that a process of unusual concentration of bank capital was occurring. Some of the factors which were leading towards this concentration have already been sketched and do not need recapitulation. It is enough to say that, as a result of the growing size of the individual banks and the limitation of their number, commercial banks in numerous countries have far more power as compared with the central bank than they had before the war. Stated in another way, this amounts to saying that the various central banks of the world have in no small degree

lost their power over the money market or discount market, an important post-war development. Some factors bearing upon this state of things have been set forth in the British report already referred to in the following language: "Any approach to a banking combine or money trust . . . would undoubtedly cause great apprehension. . . . Such a combine would mean that the financial safety of the country . . . would be placed in the hands of a few individuals. . . . Moreover, the position of the Bank of England . . . would be seriously undermined. . . . It appears to us not altogether impossible that circumstances might produce something approaching to it [a money trust independent of the Bank of England] at a comparatively early date . . . in view of the exceptional extent to which the interests of the whole community depend on banking arrangements some measure of Government control is essential."

Comparative Development. But what is true in Great Britain has been largely true elsewhere. The reserve banks of the United States have grown very greatly in scope and resources and have assumed an important position in American banking life, yet no comparison between post-war and pre-war banking conditions is possible, the reserve banks having been set on foot only in 1914. What can be said is that the reserve banks have never assumed, and do not today exert, a control over the money market, and that their discount rates follow rather than lead that market. So obvious is this fact that it has from time to time been quite frankly avowed in the official publications of the Federal Reserve Board as well as recognized elsewhere. Very much the same condition of affairs developed in Germany, France and other countries, largely due to the fact that the central banks of those states were obliged to pass through a process of progressive weakening and loss of ground owing to the necessity of various governments in leaning so heavily upon them during the war. The various commercial banks could in case of necessity, and in some instances did, write off their losses or go into bankruptcy, or amalgamate with other banks, the result in any case being that of assuming a stronger and more liquid condition at a much earlier date than the central bank in each such country could possibly reach. The latter bank was in each country obliged to struggle with the burden of public refinancing doing what it could to re-

store soundness, and accustoming itself as well as it could to the necessities of the situation created by the war, yet in most cases without materially changing its position or the scope of its obligations. It thus almost unavoidably found itself obliged to assume a relatively secondary position, either because of sheer inability to control other banks in consequence of the "frozen" or non-liquid position of its portfolio, or because of fear and other inhibitions, or because of the fact that the other banks had increased so greatly in power by reason of the consolidations already referred to.

Future of Central Bank Control. The question whether central banks will regain control of the discount market to the same extent that they possessed it before the war is in a sense a matter of prophecy or of opinion. In another sense, however, it is a question of probable tendency, and may be more or less accurately foreshadowed. Such an analysis, however, requires as a background some sketch of the control over the discount market which was actually exerted prior to the war, since only through calling to mind exactly what that control was can we form a reasonable conclusion as to the extent to which its restoration is now either probable or possible.

In pre-war days, the Bank of England, for example, was regarded as practically the pacemaker in all matters relating to credit. It practically determined through changes in its discount rate, the cost of credit to the commercial customer, while at the same time it practically was able to regulate the flow of gold into and out of Great Britain. Through such regulation, it determined the amount of gold available as bank reserves in Great Britain and hence, in an important sense, the amount of notes which could be issued, as well as the total amount of deposits that could be created with this gold as a base. The Bank of England was thus, in an unofficial way, the regulator or stabilizer of bank operations and of bank credit, and its decisions in raising or lowering its rates were both indirectly influenced by, and were indirectly influential in changing or fixing, the general level of prices. This was perhaps the most fundamental and significant power exerted by the Bank of England, and that bank applied it with an authority and skill undoubtedly superior to those of any other banking institution. During the few years immediately preced-

ing the war, moreover, these great powers had come to be more self-consciously exercised, and it was more and more widely regarded as an obvious duty of the bank to discharge them properly even at the apparent expense of its own profit. In a general way, it was probably true that the bank did act on most occasions with these broad canons of public welfare prominently in mind, the well-being of its own stockholders being regarded as, in the long run, best served by the promotion of the welfare of the financial community at large.

Bank Leadership Not Always Accepted. This kind of leadership or control was by no means always acceptable to the various banks which coexisted in the British market with the Bank of England. They were not willing to keep with the Bank more than a minimum amount of reserve, and it was not infrequently necessary for the Bank to use its open market power for the purpose of regulating rates of discount and of coercing other institutions into observance of its wishes. However this may have been, the situation was at least such as to permit the bank usually to overcome the opposition of other institutions, largely because it had a greater amount of immediately available credit power in its hands. The post-war situation is, therefore, to be studied, first of all, for indications of the ability of the Bank of England and of other banks similarly situated to reëstablish the control over other banks which was formerly exerted by them, and secondly with a view to ascertaining whether the post-war financial situation does afford, or is likely to furnish, a field which requires the use of exactly this same kind of direction and oversight. These two questions may be considered in their order as thus presented.

As to whether the central banks of the several countries are in process of recovering their leadership in point of size, as compared with the other banks of their communities, the answer must be very dubious. It may well be that in many countries there will be a decisive growth in volume of central bank resources, but the statistical position at the present time seems to point to a decidedly more rapid growth on the part of commercial banks.

International Coöperation. The difficulties of restoring control over the money markets in the several countries, and the apparent fact that central banks have been in danger of losing ground in their contest with the larger commercial banks by

which they are surrounded, has brought about an exceptionally interesting post-war development. This is the formation of an informal association or organization of central banking institutions with the purpose of mutually regulating or controlling discount rates. A relationship between central banks was first established, perhaps, during the war, when the Bank of England undertook to act as a representative of the Federal Reserve banks of the United States, and to meet various obligations for them which were incident to allied military operations in Europe. After the war was over, the Reserve System came to act as agent for various foreign central banks and eventually took on the function of investing considerable portions of their funds in local bills and notes, carrying such bills and notes in trust, and holding deposits for the foreign central banks. It also at times undertook a somewhat similar function for foreign banks, which were " central " only in name. Later, the Reserve System formed a working partnership with the Bank of England, relating to the control and direction of discount rates, and undertook to keep rates at the reserve banks not higher than a certain figure in relation to English bank rates. This working relationship was finally extended to take in Germany; and later France through the Bank of France, joined in some informal conferences of central bankers. The Federal Reserve System was already issuing a monthly bulletin as well as a local issue at each of the Federal Reserve banks, which at the request of the Reserve Board, had adopted the practice of issuing such a bulletin. This idea was copied by the Bank of England which, in 1926, began issuing a small monthly publication marked as for the use of central bankers only, and intended to furnish a very few figures bearing upon phases of central banking conditions and methods that were presumably significant from the standpoint of international central banking regulation.

Secrecy of Operations. The extraordinary secrecy which has been thrown about this central bankers " conference," as it was called (perhaps as a reminiscence of the council or conference of governors of reserve banks which had been established in the early days of the Federal Reserve System), has prevented anything more than a general knowledge of its doings becoming public. It has been well known, however, that the major purpose of

the conference was to regulate discount rates in the different markets, and thus presumably to bring about two results: (1) the redistribution of the issue of new securities in different markets; and (2) the redistribution of gold between different markets. Incidentally, the conference of central bankers has undoubtedly devoted much consideration to questions of stock-market activity and manipulation and of competition for international loans. The notion has unquestionably been that, through such collaboration, it would be possible to prevent any one bank or market from getting the advantage of any other, and at the same time to "promote the return to the gold standard" so far as might be practicable, by relieving the strain which such return to the gold standard presumably brought to bear upon certain of the countries engaged in endeavoring to effect this return; — notably Great Britain and possibly Belgium and other countries as well. The policy has naturally involved an effort to direct in various ways the policy of the larger commercial banks; notwithstanding the difficulties involved in such an undertaking and the refusal on the part of some of them to allow themselves to be directed in that way.

Theoretical Aspects. As a phase of post-war banking this effort to develop an international or super-central bank control has a very large theoretical interest. Such interest is found in the fact that the efforts which are making, and the powers which are tacitly assumed, on the part of the central banks so engaged, imply the belief that these banks can and should exert a general control over credit, and can and should dictate the conditions under which monetary conditions are fixed and maintained. Such assumption naturally represents a very extreme change from the pre-war disposition to refuse recognition of any such powers on the part of credit-granting institutions, and it should be added that European central banks have been somewhat loath to admit any such change in attitude. Their reasons for assenting to, and joining in, the central banking conferences which have thus taken place have been two in number: (1) the existence of an artificial reparation situation which in their opinion calls for more or less steady consultation between the controlling debtor and creditor countries; and (2) the fact that both they and the private bankers in their several countries felt themselves very dependent upon

the United States for loan funds. They, therefore, deemed it necessary in every way to appear to collaborate with and to inform the United States and its banking mechanism of what was being done in European markets.

PRACTICABILITY OF "SUPER-BANK." Whether it will prove practicable to maintain a continuous international, super-central bank "conference" or controlling body may well be doubted. It would be practicable, probably, only on the assumption that one or two countries continue to be able to go on dictating, financially speaking, to the others, — a situation which is not likely to exist indefinitely. That such a conference may in the meantime produce some important temporary results, particularly in connection with reparations settlements and problems growing out of them is, however, entirely likely. The effort to establish a super-central banking organization is thus worthy of note, particularly as it follows upon the breakdown of efforts, made at the time of the Treaty of Versailles, to provide for an international gold clearance fund which should result in eliminating movements of gold between countries. Proposals for the creation of this fund had at one time reached so definite a stage that they were referred to by the Federal Reserve Board in one of its annual reports in which it offered its own services as an agency for the creation and development of such a fund — the apparent nucleus of a kind of world central bank. The project met with no success, largely due to differences of opinion as to who should be the holder of the gold fund, and the current central banking conferences are the successor to it. It is probably true that world opinion in general has not reached the point where it would permit the establishment of such an organization, even if conducted with due regard to public welfare, and with reasonable publicity for its aims and objects. While, therefore, the development already described is significant and interesting, its relationship to the actual trend of post-war banking is still to be determined. A significant opinion with reference to this episode was expressed by an English banking authority in September 1927, as follows: [14]

"The problems which now await to be solved are beginning to be very different to those which had to be considered immediately after the war. Then, there was a single, simple, definite and all-

[14] *The Banker,* Vol. IV, No. 20, page 189.

important objective — the restoration of tolerable monetary conditions in Europe and in the world at large. But this problem has been solved, and it is not likely that economic and political factors will ever again in the present age produce such a chaos as prevailed immediately after the war. The problems of the future are less simple and less calculable, require more consultation and less day-to-day manipulation of the machine. . . . Upon these matters there is not even as yet agreement among theoreticians, much less unanimity among practicians. . . ."

Confusion of Functions. Partly as a result of our difficulty in controlling discount rates, and of restoring the headship of the money market which existed before the war, partly as a consequence of a non-liquid condition prevailing in many banks, and the less standardized character of finance in general, there has been not only the change in character of commercial assets which has been sketched above in most of the European countries, but there has also been an increasing tendency to the fusing of investment and commercial banking functions. This situation has naturally been most strikingly illustrated in Germany where it had been true even before the war that the large German banks were in the habit of supporting, owning and directing all sorts of financial enterprises, their own boards of directors indeed being quite often drawn from such enterprises. A very great growth of this relationship between banking and industry has, however, taken place in Germany. It probably culminated in the operation during September 1927 whereby the Deutsche Bank obtained in New York a 5-year loan of $255,000,000 for the express purpose of enabling medium-sized industrial concerns to obtain working capital for longer periods than are usually allowed by commercial banks. The transaction was unprecedented in a great many respects, and represented so pronounced a break with traditional banking practice even in Germany that the German financial press and public was undoubtedly greatly disturbed by it. Similar situations, although none perhaps of so pronounced a character, were to be noted in other European countries. The French banking system had always been inclined to do a good deal of investment financing, but its post-war policies have leaned even more heavily in that direction. British banks have been disposed to broaden their policies very considerably, and to abandon the

comparatively strict standards of banking practice to which in former years they had been so strongly attached. In the United States, the same tendency has been at work in striking fashion, and as usual has been reflected in legislation. The so-called McFadden Act, of February 1927, expressly allowed national banks to embark upon business as issuers and dealers in investment securities, and also quite definitely to put themselves into the land loan business. This, often represented as a local departure which was the outgrowth of special American conditions, was in fact nothing more than an action parallel to policies which had already been adopted in Europe, although, as usual, taking form there in practice rather than in legislation, whereas in the United States the opposite was frequently the course of evolution.

"Relief" Demanded. This change of policy and broadening of banking practice, involving as it does a fusion of types of banking which before the war had seemed to develop along non parallel lines, is the outgrowth of complex factors. It doubtless reflects, first of all, a feeling in various countries that relief measures of some kind are called for. In Germany, for example, the complaint has been constantly heard since the war that the smaller industrial enterprises were being hard-pressed by lack of commercial credits, yet could not hope to attract funds from foreign centers which were chiefly concerned with provision of cash for the use of the larger enterprises. In part, probably, the change of front was due to an altered method of supplying working capital for business enterprises. Even in the United States, where there has certainly been abundance of gold, there has been a pronounced tendency to obtain funds through the creation of stock and bonds rather than by bank borrowings; and this same tendency has, for other reasons, been paralleled by developments in Europe. These include not only occurrences of the sort already briefly sketched but likewise other considerations growing out of changes in types of industry, a steady advance of corporate enterprise, and the increasing preference for corporate securities as a form of investment.

Summary. From the foregoing review of the major post-war developments in European banking, it will be seen that the principal changes as compared with earlier conditions may be grouped somewhat as follows:

1. Those affecting the attitude of the community at large with respect to banking, and determining the accepted position of banking in economic scheme.

2. Those which have to do with the altered status of central banking and its relationship to the Government.

3. Those which relate to the new functions that have been assigned to central banking or the broadening of older functions; — the control of credit, and through it of prices, being significant under the first head, and the development of monopoly control of note issue being similarly conspicuous under the second.

4. Those which have to do with the relationship between central banks and commercial banks; — the latter having lost some portion of their old time control over the discount market, and being now engaged in the endeavor to recover it.

5. Those which have to do with the concentration of commercial banking and the increasing size of the banking unit.

6. Those which relate to changes in the portfolios of the commercial bank, and the relation between its reserves and its outstanding liabilities.

Reviewing these various modifications in the banking situation which existed prior to the war, the conclusion may be drawn that there has been not only an extensive modification of pre-war banking theory and practice, but that that modification has taken effect in ways which seem to insure its continued development along the lines that have already been mapped out. It is true that some of the changes heretofore referred to are now fully recognized, and by some regretted, and that an effort is being made to restore the pre-war status, as witness the current endeavor to reëstablish the primacy of central banks in the discount market. But these are exceptional phases of the general movement. On the whole, it would seem that banking in general, especially as typified in the European field, has entered upon a distinctly new phase of its growth. In that phase, it is tending to become much more nearly than ever before a monopoly, with decided centralization of function, increasing size of the individual unit, and large service to the community through the branch system. The various governments are endeavoring to segregate for their own use certain banking functions, notably those of note-issue and to an extent credit control, and to exercise

these functions through central banks whose definite leadership of the market is still in dispute save in so far as fortified by legislation. The fact that it is thus in dispute has tended somewhat toward a nationalization movement which seeks to place the control, or ownership, or both, in the hands of national governments; thus presumably providing them with a weapon which they can use to good effect in compelling the commercial banks to carry out such program as they may decide upon. It is difficult to say what the outcome of this struggle will be, and for the present enough has been done when we call attention to it and outline the chief underlying factors in it.

The tendency of commercial banks to concentrate their resources in a few institutions, and at the same time to depart more widely than formerly from the recognized canons of commercial banking as adopted in Great Britain, permitting themselves to develop in the investment field as well as elsewhere, is in part a result of war conditions, but it is also in part an outcome of changed industrial relationships. To some extent also it is a product of the lowered responsibility which is necessarily recognized when the banks are wholly shorn of the issue power and are in large measure deprived of any duty in regard to credit control. In such cases they naturally tend to transfer their responsibility to the government under which they exist and to its central bank, and to devote themselves very largely to the making of larger incomes through the expansion of their operations along any available lines that hold out a fair prospect of profit. They thus tend to approximate more and more to the pre-war German type of institution, rather than to the pre-war English type. The eventual outcome of this situation and tendency cannot be predicted, until much more experience and observation have thrown light upon their probable results. For the present, there is no perceptible feeling that the new trend is to be objected to, but rather the reverse.

As for the belief or opinion that it will be possible, through the control of banking, to regulate the price level, " stabilize " business, and perhaps bring about a transformation in monetary standards, it is sufficient to say that as yet these are aspirations rather than achievements. While they have taken a deep hold upon the minds of a good many financiers and administrators,

they have thus far proved instrumentalities of an individual ambition or of special interests, rather than the agencies for general good and for the elimination of uncertainty in economic relationships which they have been regarded as being. There is still much to be done in developing the theory of credit, and of credit control, before the application of practical effort in those directions is likely to be very successful. Meanwhile, however, the endeavor to use such theories as have gained a partial acceptation, in the actual management of banking institutions, is providing an interesting series of experiments in financial reorganization. The present volume is intended to set forth and review what is actually being sought along all these lines. Readers will be best able to reach conclusions acceptable to themselves with regard to the probable outcome.

CHAPTER II

THE BANKING SYSTEM OF AUSTRALIA

BY

D. B. Copland [1]

Prefatory Note. In the preparation of this brief description of Australian banking I have been greatly assisted by Mr. A. Thodey, editor of the *Australasian Insurance and Banking Record,* Mr. B. Latham of the Commonwealth Bank, Mr. H. E. Teare of the Alexander Hamilton Institute, and Mr. R. B. Lemmon, Lecturer in Business Principles at the University of Melbourne and Mr. E. C. W. Kelly, Lecturer in Commercial Law. I am also indebted to the editor of the *Economic Journal* for permission to reproduce some matter that had already appeared in that journal.

The use of the word "State" to describe the units of the federation making the Commonwealth of Australia will be familiar to American students. I should explain that the word "public" is used throughout to signify government ownership, whether State or Commonwealth. Thus the Commonwealth Bank is a public bank owned by the Commonwealth Government. There are also public banking institutions, such as Savings Banks, owned by the State Governments. Owing to the special meaning of "State" in Australia it has not been possible to describe these institutions generally as State concerns.

THE MONETARY SYSTEM: ITS NATURE AND DEVELOPMENT

Early Currency. Banking and currency in Australia cannot be considered apart from the close financial ties between Australia and the United Kingdom. Local conditions, especially the preponderance of rural interests, have produced variations from the British example, and in later years there are indications of greater independence of action by the financial authorities of Australia. It still remains true, however, that the monetary system of Australia bears marked resemblance to that of the United Kingdom upon which it is modelled. As in all primitive communities the early settlements in Australia experienced periodic difficulties in maintaining a satisfactory medium of exchange. Barter was frequently found the most satisfactory basis of

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conducting trade, and various commodities were used as money, including rum, which had, at least, the important attribute of general acceptability. In the early history of New South Wales the Spanish dollar (worth from 4/6 to 5/–) was used, but it was found impossible to maintain its circulation. Being acceptable abroad in payment for imports the dollars were rapidly exported and were rarely found in local circulation. Variations of the dollar currency were tried in 1813 when a small coin, known as "the Dump" was cut from the center of the dollar which then became "the Holey Dollar." It was hoped by this means to prevent the export of dollars and to safeguard the local currency. The two "debased" coins circulated for a time but the fluctuations in the exchange value of the dollar caused great inconvenience to traders dealing with Great Britain. Despite the efforts of Governor Brisbane (1821–5) to establish the Spanish dollar as the standard currency of Australia it was finally abolished in 1829 when a sterling currency was introduced.

Introduction of British Currency. It may appear natural that the early colonies should prefer the British currency system. Their external trade was mainly with Great Britain and the authorities were familiar with British coins. But at this time the Spanish dollar was the almost universal "coin of sea borne trade" in the South Seas, and there was a strong presumption in its favor. The restriction of cash payments by the Bank of England and the depreciation of the British paper pound during and after the Napoleonic wars gave the dollar additional support and it seemed likely that Australia would follow the example of the early American colonies in adopting it as currency. But in 1816, three years before the resumption of specie payments in England, public opinion in New South Wales had decided in favor of a sterling currency. This was on the occasion of a meeting to consider the establishment of a bank in the colony. A year later the Bank of New South Wales was opened, and as it had the right of note issue its notes became the most important local medium of exchange. Thus the colony had taken the first step in the direction of a sterling currency. The introduction of an adequate silver currency from 1825 to 1829 by the Imperial authorities and the withdrawal of the dollar currency completed the process and there has never been any serious question since

concerning the maintenance of a sterling currency in some form.

Gold Discoveries and the Coinage. For the next twenty years there were no important currency developments. More banks were established, mostly under authority from the British Government and often by British financiers in London. These banks all had the right of note issue and during the severe economic crises that affected the colonies from time to time, notably in the early forties, some experienced difficulties in meeting their obligations and others actually failed. But the whole effect of this period was to strengthen the preference for British currency and the final touch was given to the system when gold was produced in rapidly increasing quantities in the early fifties.

During the years 1850–55, towns sprang up in Victoria wherever gold was discovered. This increase of population and its concentration in urban areas created a great demand for coin which could not be supplied from the British mint. Hence there was the unusual position of gold bullion selling at less than its mint price. In South Australia, which had suffered depression through the exodus of its labor supply to the diggings in the neighboring State of Victoria, special measures were taken to issue notes against gold bullion assayed and stamped by Government authority. Holders of bullion could then procure notes for their gold at the rate of 71/– per standard oz. The price had fallen much lower in Adelaide and other places, and the local scarcity of coin was met finally by the establishment of a branch of the Royal Mint at Sydney in 1855. A second branch was opened in Melbourne in 1872, and a third in Perth in 1899, after the development of gold production in western Australia. Gold coins issued by these mints were to be of the same weight and fineness as British gold coins and were unlimited legal tender in Australia. In 1909 provision was made for the issue of an Australian coinage when the Coinage Bill was passed by the Commonwealth Government. Gold coins of £5, £2, £1 and 10/– were to be issued; silver coins of 2/–, 1/–, 6d. and 3d.; and bronze of 1d. and ½d. As in Great Britain, gold was to be unlimited legal tender, silver legal tender up to 40/– and bronze up to 1/–. The standard weight and fineness of the gold coins are the same as in Great Britain, but Australia, as distinct from Great Britain, has

retained the pre-war fineness for silver coins — namely, 925 parts silver and 75 parts copper. Early in 1910 the new gold and copper coins commenced to circulate, but silver coins were not issued from the Australian mints until 1916. The position now is that all Australian coins are issued locally, but the mints are still branches of the Royal Mint, and the gold coins issued are subject to inspection and regulation by independent authorities in London. The local mints are, however, financed by the three Australian Governments concerned — New South Wales, Victoria and Western Australia — and are in many respects independent of the Royal Mint. Approximately 56% of the total gold produced in Australia has passed through these mints, but owing to the serious decline in gold production in recent years the mints are run at a financial loss. It is probable that some reorganization will take place in the near future with a view to reducing expenses. A special feature of the development of this coinage system and minting power is that the State Governments which have no authority to legislate for the coinage have hitherto been responsible for the maintenance of the mints. It is possible, however, that the reorganization of the mints noted above may involve some exercise of latent authority by the Commonwealth.

The Crisis of 1893. No review of the development of banking and currency in Australia is complete without some reference to the financial disasters of the early nineties. Towards the close of the eighties a highly speculative land boom developed throughout Australia being especially marked in Victoria. The price of land rose to fantastic heights, imports increased rapidly at a time when the overseas market for Australian produce was depressed. The several State Governments had launched ambitious programs of public works and the public debts of the States rose quickly from £127 mills. in 1888 to £173 mills. in 1894. Between 1884 and 1888 bank clearings in Melbourne rose from £149 to £327 mills. and remained with some indecision at a high level for four years. Banks had greatly increased their advances, both absolutely and relatively to deposits, and had freely accepted highly priced land as good security. Speculation in land was the most pronounced feature of the boom and it was made possible by the policy of the banks. At this time the opportunities for invest-

ing banking funds were somewhat limited, more especially as there was almost no local market for public securities. Hence excessive holdings of land as collateral for advances was inevitable in the boom conditions of the time. The position was accentuated by the excessive importations of capital, both public and private, beyond any possibility of its economic use. As soon as confidence in the high price of land broke, the whole financial structure was imperilled and Australia experienced a commercial crisis of appalling magnitude, quite independent of the Baring crisis. From January to May, 1893, no less than 15 banks with about 1000 branches suspended payments, and excessive pessimism prevailed where a few months previously there had been unmitigated optimism. Most of the banks ultimately paid the deposits of their customers, but in the process were forced to enter upon a restrictive policy which increased the economic distress that followed the boom. Bank clearings in Melbourne declined from £245 mills. in 1891 to £125 mills. in 1894, and despite increasing prices it was 1910 before they again reached the level of 1891. The experience of these years left a lasting impression upon bankers whose subsequent policy has been, on the whole, marked by caution. Prior to the crisis the proportion of cash to liabilities was only 17% while advances were 137% of deposits. These ratios have never been reached since. The former is usually about 23%, though in recent times it has been as low as 18% owing to special circumstances noted below. The latter has rarely exceeded 90% and is usually about 80%. Banks have turned more and more to commercial securities, and in recent years to Government and municipal bonds, for investment, and the proportion of their holdings in landed securities or live stock has been greatly reduced. Special financial and banking institutions have assumed much of the business of making advances upon land, stock, and produce. Thus in many directions the great crisis of 1893 is a landmark in the history of banking in Australia.

The Commonwealth Note Issue. When the Commonwealth of Australia was established in 1901, authority was given to the Federal Government under Section 51 of the Constitution to legislate with respect to " Banking, other than State banking, also State banking extending beyond the limits of the State con-

cerned, the incorporation of banks, and the issue of paper money." In 1910 the Federal parliament acting under the authority of this Section passed important measures providing for the issue of Australian notes by the Treasury, and imposing a prohibitive tax of 10% upon the note issue of any private bank. Under this legislation the circulation of the notes of a State was prohibited, and the Queensland Treasury notes issued first in 1893 were withdrawn. The effect of these measures was to give the Commonwealth Treasury a monopoly of the note issue. Under the terms of the original act the notes were to be issued for varying denominations from 10/– upward. Notes could be issued to the aggregate value of £7,000,000 against a reserve of gold of 25%. For all amounts above this limit the reserve of gold was to be 100%. In this matter Australia followed closely upon British experience, but the Act was amended in 1911 when permission was given to issue notes to any amount on a gold reserve of 25%. The portion of the issue not covered by specie could be invested in securities of the United Kingdom or of the Commonwealth or States of Australia, or placed on deposit with any other bank. The Treasury, however, continued to act under the original act until the outbreak of war, when the note issue was rapidly increased, rising from £9.6 mills. in June, 1914, to £32.1 mills. in June, 1915. Much of this increased issue was made on the security of loans to the State Governments. The importance of this in financing the war is noted below. Changes in the management of the note issue were made in 1920 when the notes were to be issued by the Commonwealth Bank. A Note Issue Department was provided for and a Notes Board was set up to control this department. All the conditions stated above regarding reserve and investment of the uncovered balance of the notes were maintained, except that the Notes Board was given authority to issue notes against trade bills. This form of control was abandoned in 1924, when the note issue was placed directly under the control of the new board set up by legislative enactment in that year to manage the affairs of the Commonwealth Bank. The effect of these measures was to create a public note issue under federal authority, convertible into gold coin. This note issue has been the only paper money in circulation in recent years.

The Commonwealth Bank. A further important legislative measure was passed in 1911, in the form of "An Act to provide for a Commonwealth Bank." Under this Act a public bank was established in 1912. It had no right of note issue, but apart from this, performed all the ordinary banking functions. The growth of this bank, its operations, and subsequent legislation affecting it, are reviewed below under the section dealing with central banking. The Commonwealth Bank was well established when the war broke out, but the extraordinary measures required for financing the war greatly strengthened the Bank. It was through the Commonwealth Bank acting in coöperation with the other banks that the Government was able to float the war and post-war loans, and to finance the wheat and other pools which were thought to be necessary for the successful conduct of the war. As a consequence the Bank had greatly strengthened its position by 1924 when steps were taken to give it some of the functions of a central bank. It is an interesting aspect of recent currency history that the Commonwealth Government has in respect of the note issue and the Commonwealth Bank superimposed its authority upon the monetary system. Equally interesting is the degree to which a public bank and a public note issue have quickly become a recognized and approved part of the monetary system.

The Abandonment of Specie Payments. Soon after the outbreak of war Australia, in common with other belligerents, abandoned the gold standard. Gold and notes were then circulating side by side, and notes, though full legal tender, were convertible into gold at the seat of the Federal Government. In practice gold could always be obtained at any bank and was always available for export. These arrangements were completely altered soon after war broke out. In the first place an embargo was placed on the export of gold which was allowed only under license from the Federal Treasurer. Secondly, the mints no longer freely issued sovereigns to the public in return for gold bullion. Thirdly, the practice of the banks in providing gold freely was abandoned and notes became the basis of their clearing house arrangements. The Federal Treasury also discouraged the practice of paying out gold in return for notes at the seat of government and the note issue was thus virtually inconvertible.

By arrangement with the private banks notes were issued in exchange for gold formerly held in bank reserves. These measures had the effect of increasing the gold reserve in the Federal Treasury and of placing behind the note issue the authority of the private banks. Gold disappeared from circulation, and paper money, together with the usual silver and bronze tokens, became the sole medium of exchange. The note issue increased from £9.6 mills. at June 30th, 1915, to £32 mills. a year later and £52.5 mills. at June 30th, 1918. The proportion of reserve on these dates was 42.9%, 34.34% and 33.61% respectively. The reserve ratio for 1915 shows the effects of exercising the power of unlimited issue against a gold reserve of 25%. Under the limitation in the original act of 1910, the gold reserve should have been, at least, £26,750,000, in place of the actual amount of £11,034,703. The great increase in the note issue in this year was due to the adoption of this means of making loans to the States. Thus at June 30th, 1915, the Australian Notes account showed that £14,746,-550 had been invested in State Government securities and £5,-758,899 in Commonwealth securities. It is doubtful whether this great increase in the note issue was necessary even for the purpose of financing the war, but in later years of war and post-war finance the increasing note issue became a recognized part of the financial mechanism. In Australia the war was financed mainly by this loan method. Thus to June 30th, 1919, the total war expenditure was £311,452,248, of which only £45,958,584 had been raised by revenue. Almost the whole of the latter amount was accounted for by debt charges on the loans, both Australian and British, war pensions and the annual charges of repatriation. Towards a total loan expenditure of £265,493,664 the amount raised in the Commonwealth was £194,086,462. Under pressure from the Government towards the end of the war banks arranged for an instalment system for bond purchases and increased their deposits by the amount of the advances made on account of war bonds taken up by their customers. Hence there was a great increase in banking deposits which rose from £159,209,000 at June 30th, 1914, to £231,270,000 in 1919. This caused prices to rise and examination shows that there was a close connection between prices and the note issue. Despite the attitude of bankers in maintaining stable exchange during the war, and the close

trade and financial connection with Great Britain, the Australian price level moved independently of the British price level. There was a depreciation of the paper currency as shown by the rise in prices and the premium on gold, the paper price of which rose above £6 per oz. in 1920. But the percentage rise of wholesale prices in Australia during and after the war was not as great as the movement in British prices. Until the great deflation of 1920 Australian prices were lower even than American prices compared with 1913 as base. Exchange rates with England were remarkably stable, despite the disparity of the price level and it was not until 1921 that serious exchange difficulties were experienced.

The Return to Gold. It is necessary to postpone a full discussion of the events leading to the restoration of the gold standard until the basis of Australian exchange and the position of the central bank are fully examined. Australia was ready for the resumption of specie payments long before the step was taken, and apparently awaited action by Great Britain. During 1924 the exchanges were favorable and the price level fell to parity with U. S. A. prices. When the sterling dollar exchange moved towards parity at the beginning of 1925 it was profitable to import gold from the United States, for the Australian pound was at a premium with the British. As the banks had been complaining of low cash reserves in Australia and ample funds in London this movement of gold was encouraged and imports during the early months of 1925 amounted to over £10,000,000. In these circumstances the decision of Great Britain to restore gold payments in April was welcomed and Australia took a similar step. The embargo on the export of gold was raised and notes became convertible into gold at the head office of the Commonwealth Bank. But the Ministry expressed the hope that "the public would refrain from presenting notes for gold" and Australian notes and tokens continued as the sole medium of exchange internally. Gold became available for export and the exchanges returned immediately to par. The Australian currency is now somewhat similar to British in that notes are convertible into gold for foreign payments, though they are universally accepted for internal circulation. But there are some special features of the monetary system which require a dis-

cussion of general banking problems for their elucidation. In particular, the system of issuing notes against gold in London which was adopted in May 1925, though a special measure to meet the conditions of the moment, may lead to important changes which can be considered only after an examination of the exchange connection with Great Britain.

CREDIT INSTRUMENTS

Types of Credit Instruments

(i) The ordinary *commercial check* familiar in all English speaking countries is used extensively in Australia. It is defined in the Bills of Exchange Act (Sec. 72) as " a bill of exchange drawn on a banker payable on demand."

(ii) The *bank check* used in final settlements where titles pass and the creditor desires the equivalent of cash.

(iii) The *bank draft* drawn by a bank upon one of its own branches or upon another bank.

(iv) The *promissory note* defined in Sec. 89 of the Bills of Exchange Act as " an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand and at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person, or to bearer."

(v) The *bill of exchange* defined in Sec. 8 of the above mentioned Act as " an unconditional order in writing, addressed by one person to another, signed by the person to whom it is addressed to pay on demand, and at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person, or to bearer."

All these instruments are negotiable in some degree. The law relating to them is set out in the Bills of Exchange Act passed by the Commonwealth Parliament in 1909 and amended in 1912. This is a comprehensive measure superseding State legislation on the matter. It follows very closely British law, and the banking procedure in drawing and negotiating credit instruments is modelled on British practice. Further, British case law on credit

instruments is regarded as applicable to Australia, and is frequently quoted in the Courts. In banking procedure relating to credit instruments "the letter of credit" plays an important part, and is sometimes classed as an additional credit instrument. In one sense this is true because it is an instrument through which purchasers or their agents arrange the financing of their dealings. But the letter of credit, strictly speaking, is a means to the use of other instruments, supplying, as it were, the holder's credit, as would an actual account at the bank. It cannot be negotiated except through other instruments, and for this reason is not included as an independent credit instrument, though it must bulk largely in the discussions which follow.

The Check System. There is no reliable measure of the relative importance of payment by check and payment by cash in internal transactions, but it is quite certain that the former, as in Great Britain, is responsible for a much larger aggregate value than the latter. The proportion of cash reserves to deposits in the commercial banks varies from one-fifth to one-fourth. This is some indication of the importance of check payments. The large volume of clearing transactions points in the same direction. Thus for 1925 they amounted to £2,177,-000,000 for the clearing houses at the five capital cities of the mainland. As the total number of independent trading banks in Australia is only nineteen, this amount indicates the importance of check transactions. Checks are used extensively for all payments in trade dealings, both local and inter-state. The bank check or bank draft may be used in special circumstances, and promissory notes and bills of exchange are also used according to credit terms arranged. But the check habit is remarkably well developed in Australia, despite the preponderance of rural production and the large areas for which banking facilities have to be provided.

In the negotiability of checks Australian practice is similar to British. An open check, that is, one not requiring endorsement, is used chiefly by the drawer in procuring cash for his own purposes, or in cases where the check is handed direct to the payee. Even then, the latter may make it payable to order, in which case it cannot be negotiated except with his endorsement, or he may cross the check when it must be paid into a bank

account, though not necessarily his own account, so long as it bears his endorsement. If such a check were marked "not negotiable" it would require to be also endorsed by the payee and paid into his account direct. If this procedure is not followed the collecting bank would be responsible to the true owner if it is collected for a person who has no title to it, unless it could show that it received payment in good faith. These forms of crossing may be carried out by a drawer, a payee, or a holder and the Act provides that "a crossing authorised by this Act is a material part of the cheque; it shall not be lawful for any person to obliterate, or, except as authorised by this Act, to add to or alter the crossing." (Sec. 84). Under these conditions the use of checks is encouraged, and they may be sent through the post without fear of fraud.

In some cases, as noted above, the creditor will not accept his debtor's check, but prefers cash. Where the amounts are large as in the final settlement of real estate transactions, payment may be made by means of the bank-check. This is really an order by the bank on itself in favor of its customer (the debtor), or a payee named by him. The debtor hands his own check to the bank receiving in exchange the bank-check which is readily accepted as cash by the creditor in exchange for the title deeds or other documents. Although bank-checks may be described as drafts drawn by the bank on itself, they are not regarded as coming within the usual category of bank drafts and are used only for special transactions of the type indicated. Again, they may be regarded also as bank notes and according to one authority where they are "payable to bearer on demand and intended for circulation" they would be liable to the special taxation provided in the Bank Notes Tax Act of 1910.

Letters of Credit. Before dealing with drafts, promissory notes, and bills of exchange it is necessary to describe the part played by letters of credit in banking and exchange transactions. Letters of credit are used in both domestic and foreign trade. In domestic trade there are two types. (i) The simplest form is the letter of credit enabling the customer of a bank who is travelling to draw checks upon its branches. The amount is specified in the letter and the customer requiring the letter gives the bank a check for this amount before obtaining it. Each

branch against which checks are drawn specifies the amount on the back of the letter in the space provided and, of course, the letter contains a specimen signature of the holder. (ii) Another type is used in commercial transactions by a customer of the bank who sends his agent to the country, or to another State, to purchase goods. The letter directs the branches of the issuing bank to negotiate the demand drafts of the agent upon his principal (the customer) to a specified amount and there are provisions for recording the amount of the drafts so negotiated. The first is the procedure usually adopted by travellers visiting places where they are not known. All drafts and checks drawn under these letters are, of course, subject to the exchange rates ruling for intra-state or inter-state trade.

Of much more importance are the letters of credit used in foreign trade. These are mainly of two kinds — the Circular (or Clean) Letter of Credit and the Documentary Credit. In both cases the *amount* is specified in the letter. Under the circular letter of credit which the holder carries about with him he may draw upon the issuing bank and get its branch or agent wherever he may be to negotiate the draft on production of this letter of credit and his letter of introduction or identification, the latter of which contains his specimen signature. This is the routine generally used for travellers abroad as distinguished from that followed by merchants in their regular business dealings. In the second case, that of the documentary credit established to facilitate foreign buying, the bank issuing it for a customer notifies its branch or correspondent abroad that it has granted the credit in favor of the foreign merchant. The latter is then entitled to take the bill drawn on his customer with the shipping documents and to receive the cash in exchange therefor. Thus if an Australian merchant desires to purchase goods in London, he obtains a letter of credit in favor of his agent or supplier abroad who draws upon him and negotiates the bill through the bank in London specified in the letter. The shipping documents (bills of lading, insurance policy, and invoices) are attached to the bill and sent to the bank in Australia, which presents the bill to the merchant in Australia. On acceptance, the documents, under ordinary conditions, are released, and the merchant gets possession of the goods, meeting the bill in due course. If cir-

cumstances have arisen in the meantime, throwing doubt on the merchant's standing, the bank may require him to meet the bill before releasing the documents. Similar arrangements, *mutatis mutandis,* are made in Australia by British or other importers purchasing Australian produce. Thus the wool purchasers in Australia are financed in this way. Dealings with foreign countries are financed through London in a similar way, the buyer's agent being authorized to operate under the credit to draw upon a bank in London instead of on the buyer as is usual in export and import trade dealings between Australia and London.

It is necessary to repeat that a letter of credit is not a negotiable instrument but a means of procuring such an instrument. It, nevertheless, plays an extremely important part in both internal and external finance.

Bank Drafts. Strictly speaking they are bills of exchange payable to, or to the order of, the payee named therein. They are used in both domestic and foreign trade, but are not as important as the usual type of bill of exchange considered in Section 6 below. The bill of exchange offers the great advantage that in most cases the purchaser in good credit, whether Australian or foreign, can act on a letter of credit through his agent, and does not need to provide funds until the bill drawn on him by his agent matures. With the bank draft the funds must be provided when the draft is purchased. This may be done by means of a temporary overdraft, when interest would be demanded. When obtained, the draft becomes an order by the bank on its branch or agent to pay the sum specified to the payee. The draft is used only in exceptional circumstances when, for example, it is not desired to operate under a letter of credit, or again where the individuals concerned are not regular traders and make and receive only occasional payments. The banks, however, usually find it convenient to sell drafts either in London or in Australia because they have funds in both places by virtue of their exchange operations.

Promissory Notes. These are used extensively in internal trade where a trader buys on the longer trade credit terms, usually three months. Usually no collateral is held, but in the case of purchases made on the instalment plan, the vendor takes a promissory note or notes and holds as collateral a hire pur-

chase agreement entitling him to claim the goods in the event of the buyer's default. This form of transaction is very common and is increasing in Australia. The note is in the form of a promise by the maker to pay to the order of his creditor, named in the note, the sum specified. The note is signed by the maker and is made payable at a bank named. The payee endorses it on the back, and very frequently discounts it at his bank, or he may hold it for presentation at the due date. The law relating to bills of exchange applies, *mutatis mutandis*, to promissory notes, the acceptor of the bill corresponding with the maker of the note (Sec. 95).

Bills of Exchange. Reference has already been made above to the place of the bill of exchange in the export trade. According to the Act (Sec. 9), this type of bill is classed as a "foreign" bill. The other type defined in the Act is the "inland" bill which is "both drawn and payable within Australasia, or drawn within Australasia upon some person resident therein." All other bills are foreign. Australasia (Australia, New Zealand, and their territories) is used in this definition because many of the banks operate throughout Australia and New Zealand. Inasmuch as the Act states (Sec. 10) that "a bill may be drawn payable to, or to the order of, the drawer; or it may be drawn payable to, or to the order of, the drawee," bank drafts noted above came within the legal definition of a bill and are subject to the same legal provisions regarding negotiability. All bills are negotiable except such as "contain words prohibiting transfer, or indicating an intention that they should not be transferable" (Sec. 13). Bills may be payable to bearer or to order. In the former case, which is unusual, they are "negotiated by the delivery," and in the latter case "by the endorsement of the holder completed by delivery." (Sec. 36). For endorsement the signature of the payee as designated in the instrument is sufficient and the bill then becomes negotiable. But it may be "restrictively indorsed" (Sec. 40), giving the endorsee the right to receive payment, but not to transfer this right. In this case it ceases to be negotiable. Provisions regarding presentment and acceptance follow British precedent and need not be stated in detail.

In Australian trade the bill of exchange is used freely by

foreign buyers of Australian produce and Australian buyers of foreign produce. In Section 5 above it was stated that the purchaser operated through an agent whom he had supplied with a letter of credit. Taking the example of the sale of wool in Australia to a British firm, the Australian agent of the firm, fortified with his letter of credit, draws on his principal in London at 60, 90, or 120 days through a local bank according to arrangement. The number of the letter of credit is stated in the bill which is handed with shipping documents to the bank for discount. This enables the British firm's agent to pay the producer or seller of wool in Australia, and the bank forwards the bill with documents to the London office to be presented for acceptance, and later for payment by the British firm which is the drawee. Such documentary bills are most common, but clean bills may also be used in which case no documents are required. The documentary bill has obvious advantages in that it is negotiable during the transit of the goods to London while the London buyer does not need to provide funds to meet the bill until, at least, he has received the goods, though his agent obtains cash in Australia to settle with the seller. In ordinary cases the British importer receives the shipping documents on accepting the bill, and does not need to provide funds until the due date of the bill. The inland bill is used occasionally in inter-state trade, being sent through the bank with shipping documents to be handed over on acceptance or payment according to terms. Like the bill of exchange in foreign trade it may be negotiated at the place of dispatch of the goods. The drawer will then receive immediate payment and the bank will collect from the drawee. On acceptance of the bill, the latter may receive the documents entitling him to the goods, or he may have to meet the bill before getting possession of such documents.

Credit Instruments and the Money Market. In subsequent discussions of bank investments and the position of the central bank, reference will be made to the nature of the money market in Australia. As this is dependent to a considerable extent upon the type of credit instruments in use, it is necessary at this stage to introduce a brief comment upon the subject. The Australian money market differs from the London money market in three important respects. First, there is no purchase and sale

of bills of exchange; secondly, there are no specialized bill broking and discount houses; and, thirdly, the practice of re-discounting has not yet been developed. The last two matters are discussed later. In regard to the first, it will be observed that most bills used in Australian trade, both internal and external, are drawn upon individual traders, and not upon well established acceptance houses. Hence the ordinary bill of exchange is not comparable with the bill in London used extensively in general international trade, and is in no sense a first class liquid security available for short period investment. In their methods of financing external and internal trade, the Australian banks do not offer facilities for the development of a short loan money market. This applies equally well to the other credit instruments used in Australian trade. Hence short period investments will continue to be confined to stock exchange securities as has been largely the case in America.

MINOR BANKING INSTITUTIONS AND FINANCE COMPANIES

CLASSIFICATION OF BANKING INSTITUTIONS. Before proceeding to a discussion of the minor banking institutions of Australia it will be convenient at this stage to give the following classification:

(i.) *The Commonwealth Bank* which undertakes all the functions of banking, including savings bank business, and rural credit advances, for which there are special departments. But its chief significance is its position as a central bank.

(ii.) *The Commercial Banks,* of which there are eighteen. Three of these have their head offices in London, and a further three, including the Bank of New Zealand, are foreign banks with branches in Australia. The remaining twelve are essentially Australian institutions with head offices in Australia and branches in London.

(iii.) *Land and Rural Banks,* including State agricultural banks, credit foncier banks, and coöperative credit societies.

(iv.) *Finance and Investment Companies,* including Pastoral and Land Finance Companies, Friendly Societies, Insurance Companies, Trustees, Executor and Agency Companies, and Building and Investment Societies.

(v.) *Savings Banks,* of which there are, in addition to the Savings Bank Department of the Commonwealth Bank, State institutions in New South Wales, Victoria, South Australia, and Western Australia, and two trustee institutions in Tasmania.

Finance and Investment Companies. In some of these institutions, notably those in group (iv), the banking functions are only incidental to the other and more important operations. The pastoral companies are engaged chiefly in marketing primary products, but they also make advances against the sale of farm products and grant loans to farmers on land, stock, and other securities. They arrange for the purchase and sale of land, and in this way have played an important part in rural finance. The funds at their disposal are obtained from shareholders' capital and the issue of debentures. Taking the five most important companies the loans, investments and advances amounted to £17,000,000 at June 30th, 1924. Friendly societies have been extensively established in Australia, and it is estimated that one-third of the total population comes within the scope of their activities. They are, of course, mainly concerned with the provision of invalid and death benefits for their members, but they have accumulated funds of over £10,000,000, which are invested in Government securities and loans on mortgages to their members. Insurance companies have a similar interest to the student of banking though they operate on a much larger scale. In 1923 the total Australian assets of life insurance companies were nearly £90 mills. of which more than half was invested in Government and municipal securities and approximately 20% in mortgages. The other two main items of investments were loans on policies amounting to £8 mills. and land and house property to £3.5 mills. In making advances on policies insurance companies are undertaking a banking function, and by their general investments they provide funds for the development of industry. There are twenty Trustees, Executor and Agency Companies and in 1923 they were administer-

ing estates to the value of over £70,000,000. They frequently have funds for investment which are used in great measure for the purchase of public securities, and for making advances on real property. In such activities these companies are engaged in banking functions, though their investments are mainly in long term loans. There were 231 building and investment societies registered in Australia in 1923 with total assets of over £8,000,000. Approximately 90% of the assets was held in advances on mortgage, and it may thus be said that these societies were engaged in issuing credit for the purpose of building operations.

The position of these five types of companies and societies in the financial structure is interesting. In one sense they relieve the banker from the necessity of making advances on property and land, and thus of tying up a considerable proportion of their funds in non-liquid securities. In another sense they compete with the banks for deposits, but on the whole their funds are obtained by a large number of small contributions, collected at considerable expense, by trading capital and by the issue of debentures, and by trust moneys. Banks ordinarily would not handle these funds; nor would they desire to engage in the special loan operations of these institutions, which not only increase the funds available for investment, but also make advances on securities not accepted widely in ordinary banking practice. Their special banking function is indeed to make long term advances upon non-liquid securities, knowing that there will not be a call upon their own funds. Their cash requirements are small and a long period investment on reasonable security has real attractions. Pastoral companies also make advances on produce awaiting sale. This is a department of finance for which they are specially adapted.

Land and Rural Banks. In South Australia, Queensland, Western Australia, and Tasmania there are State banks for the special purpose of making advances to rural producers. In Victoria and New South Wales special departments of the State Savings Banks have been created for this purpose, and under a new and important Coöperation, Community Settlement and Credit Act of New South Wales passed in 1923 the establishment of coöperative societies with wide facilities for raising funds is contemplated. A recent amendment of the Commonwealth

Bank Act provides for a Rural Credits Department, as noted above. In addition to these facilities the States have provided advances to settlers as a part of their general land policy. Coöperation in Australia has not been so successful as in many older countries, but the societies are predominantly rural institutions. The total capital (loan and share) of such societies in 1923 was £6,585,994 of which producers' societies held £4,786,150. These had sales amounting to nearly £40,000,000, while the sales of consumers' societies were only £6,250,000. Some of the societies are mere companies in which the shares are held by the producers who receive dividends in the ordinary way, others are true coöperative bodies in that the dividend is according to purchases. But all companies undertake important financial functions for producers. In 1923 there were 222 producers' societies with a membership of 168,000 and a share capital of £3,333,000. The societies are strongest in the dairying industry in the form of coöperative butter and cheese factories and milk distributing agencies. These societies, together with the State banks, the special departments of the Savings Banks, the provisions for State advances to settlers and the Rural Credits Department of the Commonwealth Bank, complete the institutions which make special advances to rural producers.

Taking the agricultural banks first it is to be noted that while their functions are broadly similar their administration is not uniform. All make loans upon land as security, but the amount of the funds available vary in the several States. Thus in Tasmania advances are limited to 50% of the total value of the land and the maximum loan is £1000. In South Australia the maximum is £5,000, and the loan must not exceed 60% of the unimproved value and 33⅓% of the improved value. In Queensland loans may be made to coöperative companies and in South Australia to local bodies. The Agricultural Bank of Western Australia may advance money for many of the preliminary expenses involved in clearing and fencing the land. Similar provisions are found also in Queensland. The original purpose of these institutions was to enable farmers to settle on the land, not to provide credit for long established farmers who found themselves in difficulties, nor to make advances upon products awaiting sale. The latter functions are the special duties of the

pastoral and finance companies and until recent years there has been no organized demand for any modification of the practice of the State banks. In general these banks have been well managed and have successfully performed the services expected of them. Their funds are obtained sometimes from issues of debentures, but mainly from capital raised by the Government. Supported as they are by the authority of the Government they can trade on a relatively small capital. Advances are repaid over varying periods of years, and the rate of interest is generally lower than banks and investment companies usually offer.

In New South Wales the Rural Bank Department, and in Victoria the "*Credit Foncier*" Department of the State Savings Bank in each case undertakes these functions. Capital is obtained partly by the Savings Bank investing portion of its funds in the department, partly by the issue of debentures and partly by accepting money on deposit. Advances are made to producers on conditions similar to those already described for the agricultural banks. Advances are mainly in the form of long period amortized loans, though in some cases accommodation is given on produce awaiting sale. It is recognized that the latter type of loan should be granted mainly by institutions which have experience in handling the sale of farm produce.

State Advances to Settlers. In all States there are also additional provisions for advances to settlers. Thus in Victoria the Closer Settlement Board may make advances to Crown lessees, to workmen for the erection of dwellings, to returned soldiers, to Cool Stores Trusts and to settlers affected through drought. Funds are provided from Government loans and certain limitations with respect to the amount of the loan and the nature of the security offered are imposed. Similar provisions are to be found in other States and it is a special feature of rural finance that the State offers much assistance to producers. This is, of course, characteristic of Australian economic conditions generally. The experience of Government action in the provision of rural credit is interesting in that it demonstrates the possibility of State activities of this nature being successful when the administration is satisfactory. The conditions were unusual in that much of the settlement of Australia has been carried out by men with little original capital who might other-

wise have been denied the opportunity of acquiring land. But it should be remembered that the advances were made mainly in a period of rising prices and rising land values, and the securities were thus steadily appreciating. In recent years owing to the fall in prices and the heavy expenditure on account of soldier settlement a considerable strain has been put upon Governments providing funds for this purpose and large losses have been incurred. A further fact of importance that requires repetition is that the State institutions have not to any great extent indulged in short period advances upon produce that might depreciate in value owing to a decline in prices. The practice of the States has been to take up those functions of banking which had a large element of routine, and this is one important reason for the success so far achieved. That the contribution made by the States to rural settlement by their several institutions for providing advances to settlers is substantial is shown by the fact that up to June 30th, 1923, no less than £85,882,884 had been advanced in all, of which £58,338,995 was outstanding. Of this amount roughly £36,000,000 had been provided by the savings banks or the agricultural banks, of which £21.5 mills. was outstanding. One-third of the total advances went to returned soldiers, a great deal of it on very doubtful security. The management has not always been free from political interference. One authority remarks concerning the Agricultural Bank of Western Australia that "some loans were made to the full value of the security offered, careful inspection by the bank was discontinued, and the management of the institution became subject to political control." Finally, in spite of these credit activities of the State the provision of rural credit is still largely in the hands of the private company and merchant, and the local storekeeper. Excluding facilities for pioneer settlement the State provision of rural credit has not vitally affected the operations of private institutions.

Rural Credit. There has been a revival of interest in rural credit problems in recent years and both State and Commonwealth legislation has included special provision for financing rural industries. By far the most comprehensive measure is the New South Wales Act of 1923. Provision is made for eight different types of coöperative society. With the exception of

Rural Credit Societies the liability of members is limited and all societies are to be registered. Funds of the societies may be obtained by capital subscriptions of members, by borrowing and by deposits of members and others. The societies cover a wide range of activities including the functions of ordinary producers and consumers coöperation, the settlement of land, the provision of community services such as water, gas, building assistance and credit for the purchase of farm, household and working equipment whether rural or urban. Dividends on share capital are limited to 8% and provision is to be made for an adequate reserve fund. The act is designed to encourage coöperation and to safeguard societies as far as possible against bad management, but it yet remains to be seen how far societies will be established. In Australia, where the assistance rendered by the State is so liberal and individualism is still strong among rural producers, coöperative activities are limited.

The Commonwealth Government has also passed an important rural credit act. Under the act a special department of the Commonwealth Bank is to be established for the purpose of granting advances to producers and societies against produce awaiting sale or shipment. This is an important break in the traditional credit functions of State institutions and involves the assumption of technical risks which hitherto have largely been the responsibility of pastoral and finance companies. Funds are to be provided by the Commonwealth Treasury to a maximum of £3,000,000, by the allotment of 25% of the annual profits of the Note Issue Department to a maximum of £2,000,000 and by short period debentures to the amount of the total advances made. Advances are to be for periods not exceeding one year and the Rural Credit Department holds a lien on the produce against which advances are to be made. The new department will assist coöperative companies through which producers sell their goods but its activities are limited by the funds available. The maximum capital of the Department from the profits of the Commonwealth Bank or from the Treasury will be £5,000,000. Further funds are obtainable only by the issue of debentures, the success of which will depend upon the administration of the Department, and the degree to which the money market can provide money for the purpose. The Department has now been

established, but it is too early to say how it will affect the investment market. An interesting possibility is, however, the facilities it will offer for short period investments and the assistance it will render in the development of a short loan market for Australia.

In other States rural coöperative societies and pools for the disposal of primary production have been assisted from time to time by the State banking institutions described above. Thus, in Western Australia the Agricultural Bank made advances to the Wheat Pool. In Victoria a bill has been submitted to Parliament under which the Savings Bank Commissioners may establish rural banks anywhere in the State. These banks will be able to receive deposits and grant overdrafts, and generally perform the functions of an ordinary bank. Hitherto depositors with the Savings Bank have not been able to draw checks against their accounts, but this will be possible under the proposed rural banks. It is appropriate to mention in connection with the general interest in rural credit that a new bank has recently been established under the name of "the Primary Producers' Bank of Australia." On June 30th, 1924, it had a paid-up capital of £199,333, and is an ordinary joint stock bank. It differs from the other banks in that it pays interest on current deposits and aims at assisting primary producers from whom it draws its capital.

Savings Banks. Reference has already been made to the rural credit activities of the Savings Banks of New South Wales and Victoria. Savings Banks were established as State institutions in all States, and when the Commonwealth Bank was established in 1912 provision was made for a Savings Bank Department. This department eventually absorbed the State Savings Banks of Tasmania and Queensland, but there are two trustee savings banks in Tasmania. These institutions are unique in the banking system of Australia. They have no share capital and are managed by a committee of trustees. The savings banks as a whole do not offer facilities for drawing checks, but they afford the small depositor many of the advantages of a current account, and in addition allow interest on the minimum monthly balance, making no charge for keeping the account. In some cases special facilities are provided for children's savings. Inter-

est is allowed at rates varying from 4¾% in the State Savings Bank of South Australia to 3½% on the final £300 with the Commonwealth Savings Bank where the maximum deposit is £1300. The maximum deposit allowed also varies, being £1000 on the average. The total number of depositors exceeds 2,500,000 and the average account is nearly £50. Deposits may be withdrawn at short notice and as interest is allowed on current deposit, the rates are on the average lower than the rates allowed on fixed deposits by the commercial banks. Branches or agencies of the banks are established extensively throughout Australia. The banks hold about 20% of their funds in cash or liquid securities and the greater part of the remainder in Government and municipal securities. State Governments find the increasing assets of the Savings Banks a convenient source for raising loans and in 1924 out of total assets of £140,000,000 approximately £74,000,000 was invested in Government securities. The connection between the Savings Banks and the provision of funds for other State banking institutions and advances to settlers has already been described.

THE COMMERCIAL BANKS

For the purposes of classification the Commonwealth Bank is excluded from this category, though its operations include commercial functions. Its position as a central and note issuing institution is of much greater interest and its operations will be described in Section VI. The commercial banks have not issued notes in Australia since the Commonwealth notes were issued in 1910 and the special Commonwealth tax on bank notes was levied. But some of the peculiarly Australian institutions still have a note issue in New Zealand, where there is no state or banking monopoly of the note issue. Apart from the issue of notes in Australia the commercial banks perform all the ordinary banking functions.

Concentration in Banking. The fifteen banks with headquarters in Australia or London had a total paid-up capital of approximately £30,500,000 on June 30th, 1924. Of this, nearly 90% is held by the nine most powerful institutions. The degree

of concentration is even more strikingly illustrated by saying that six banks have 75% of the total paid-up capital. Branch banking has been extensively developed and, exclusive of the Commonwealth Bank, there are nearly 2,700 branches of the commercial banks throughout Australia. Here again the degree of concentration is most marked, the nine banks above referred to having over 85% of the total branches. This position has been intensified by the development of amalgamation as indicated by the statistics quoted in Appendix I. During and since the war six banks were absorbed and one new bank — the Primary Producers' Bank of Australia — was opened. Thus the number of banks with head offices in Australia or London excluding the Commonwealth Bank, has been reduced from the pre-war figure of 20 to the present number of 15. It is not necessary to enter into a discussion of the respective merits and demerits of branch and independent banking. The system in Australia was copied from Scottish practice early in the last century before it had been developed to any extent in England. Against the system it is sometimes urged that it concentrates banking power in the hands of a few institutions, and imposes difficulties upon small independent banks making a start. A recent writer remarks that " it has been, and is still, an extremely difficult matter for any foreign, or projected local organization, to get a footing in the country, and attempts in this direction have not, on the whole, met with a great success." There is close agreement among the commercial banks and in Victoria " the Associated Banks of Victoria " decide many important matters of policy. In conjunction with Sidney banks, they fix the rates of exchange between Australia and London and though the rates of interest on overdrafts and advances and the rates of interest on deposits are matters for individual action, the banks usually act in agreement in these matters. The Association is recognized by and usually works in close coöperation, with the Government. In all States the banks are associated for the purpose of clearing operations and where the number of large institutions is so few it is easy to agree upon a general policy. To the charge that this encourages a banking monopoly, the banks would doubtless reply that they provide in full measure all the ordinary banking services required in the country, and that the system of

central control with branches is in keeping with the general centralization in Australia in both public and private business. The system has a positive advantage in arranging the financing of the external trade of Australia and in regulating monetary conditions in accordance with British policy. This will be apparent when the Australian exchanges are discussed.

In all the State capitals, except Hobart, there are clearing houses through which inter-bank indebtedness is settled. The clearing operations include bills and drafts as well as checks, which constitute the bulk of the transactions. At first the basis of the clearings was gold deposited with one bank or, as in Victoria, with the Associated Banks' Inspectors. Certificates were issued against this gold, and each bank was required to hold an agreed proportion of certificates to capital. During the war Australian notes were used in place of gold, and this practice was maintained until the passing of the amendments to the Commonwealth Bank Act in 1924. It was then stipulated that all clearings were to be carried out by means of checks drawn on the Commonwealth Bank. This arrangement is now in operation, and it should encourage the centralization of the gold reserve and the building up of a central banking system. There are three clearings daily on the British plan, except on Saturdays when there are only two. In Melbourne clearings were first arranged through the Associated Banks and in Sydney through the Banks' Exchange Settlement Office. The details of clearing operation are similar to British and it is not necessary to describe them.

The Control of Banking. There is no comprehensive banking law for Australia. All States have the power to legislate for banking, and though possessed of the necessary power the Commonwealth has not yet passed a comprehensive banking law. Acts dealing specially with banking refer in the main to minor matters, but the Companies' Acts provide in varying measure for the regulation of banking, and banks must be registered under one of the State Companies' Acts. Every bank must twice yearly issue a statement of its financial condition with details of assets and liabilities. There are no statutory provisions regarding the proportion of reserve to liability and no limitations are imposed upon the investments a bank might make. The Vic-

torian Act of 1918, which is the most comprehensive State Act, provides that advances may be made against lands, houses, ships, or pledges of merchandise, but bankers with the example of 1893 still fresh in memory use this power with great caution. Indeed the cautious policy of bankers generally is the only real safeguard against maladministration, and under a system of independent banking it would be necessary to pass comprehensive banking Acts providing for the regulation of banking practice. The Commonwealth legislation, in addition to the Bills of Exchange Act referred to in Section II, deals mainly with the issue of notes and control of the Commonwealth Bank and is outlined later. An important provision of the Commonwealth Bank Act, as amended in 1924 is, as noted above, the obligation imposed upon the commercial banks to settle their clearings by checks upon the Commonwealth Bank, and to prepare a weekly statement of assets and liabilities on a prescribed schedule. Each quarter an abstract of the average of these weekly statements is to be forwarded to the Commonwealth Treasurer for publication in the Gazette. But this follows the long established requirements of State legislation.

Banking Statistics and Policy Regarding Deposits and Advances. The most reliable information upon deposits and liabilities is to be found in the quarterly returns issued by the banks. These returns are the average of the weekly statement for the several items disclosed and refer to Australian balances only. The half-yearly balance sheets state the condition of the bank at a specified time and include overseas business as well. The former will be used in this analysis, and the returns given below are taken from the *Australian Banking and Insurance Record*. They are slightly different from the statistics issued by the Commonwealth Statistician, but these include returns from two very small institutions not referred to by the *Banking and Insurance Record*. The returns as given on page 73 have been calculated from the information published in the *Banking Record*.

The returns are given for a normal pre-war year, and two post-war years. Figures for 1924 are somewhat abnormal as will be noted when the exchange system is under discussion. The Commonwealth Bank is not included in the statement and

	Deposits						Proportion Reserve to	
	Not bearing Interest	Bearing Interest	Proportion bearing Interest	Total	Advances	Reserves	Deposits not bearing Interest	Total Deposits
1913								
March	63.3	82.7	56.6	141.0	119.4	33.7	53.2	23.1
June	60.7	83.0	57.7	143.7	117.1	35.9	59.1	24.9
Sept.	58.9	83.0	58.4	141.9	117.2	37.6	62.6	26.5
Dec.	62.8	83.7	57.1	146.5	118.2	38.1	60.7	26.0
1919								
March	85.6	99.3	53.7	184.9	168.0	41.5	48.5	22.5
June	88.7	102.2	53.6	190.9	172.2	41.3	46.6	21.6
Sept.	91.5	99.9	52.2	191.4	166.7	45.3	49.5	23.6
Dec.	97.3	97.9	50.2	195.2	156.6	46.5	47.8	23.8
1924								
March	111.1	133.2	54.5	244.3	212.4	44.8	40.7	18.4
June	106.2	130.6	55.1	236.8	207.9	42.9	40.5	18.1
Sept.	98.2	131.7	57.3	219.9	209.7	43.7	43.5	19.9
Dec.	101.9	132.8	56.6	234.7	210.5	44.0	43.2	18.7

NOTE. — Advances include Government and other public securities held locally.

in all cases the actual balances in Australia are given. It is possible from this table to obtain some leading ideas of the policy of the banks. First, it will be noted that the proportion of "fixed" to total deposits varies between 50% and 60%, being exceptionally low under the boom conditions of 1919 and higher in more normal times. Secondly, the advances are always lower than total deposits, the highest proportion in recent years being 91%. Thirdly, the banks in normal times keep cash reserves of nearly 50% and 25% respectively against current and total deposits respectively. The proportions for 1924 were unduly low owing to the general difficulties created by the commercial crisis that developed in Australia at the end of 1920 and the special problems created by the abnormal exchange situation.

Banks pay interest on deposits for a minimum period of three months, the rate varying with the duration of the deposit. At present (February, 1926) the rates rise from 3½% on three months

deposits to 5% on deposits for two years. An increase in advances eventually increases deposits. Under the Australian system of overdraft a bank grants to its client the right to overdraw an account to a prescribed limit. As soon as the client has used this right by drawing a check in favor of some creditor, the latter may use the check to increase his deposits at his own bank. Even if the creditor uses the check to liquidate an overdraft it releases spending power at some point and will, therefore, help to increase total deposits ultimately. This is the banks' power to " create " credit and its limitations are familiar to banking students. The banks' cash reserves will ultimately impose a check upon advances, but towards the end of the war this check was not operative. The Government issued ample supplies of paper money and encouraged the banks to grant advances for the purpose of raising loans. The cash reserve was sufficient and credit " inflation " was made possible. In 1923–24 the position was reversed. The Notes Board adopted a restrictive policy and cash reserves were thought to be inadequate. Hence banks found it necessary to restrict advances. Up to the present the banks have been influenced mainly by the proportion of cash reserves to liabilities in their credit policy and there are no indications that this attitude is likely to be changed in the immediate future. But the connection between advances, deposits and cash reserves cannot be fully explained until the exchange system is discussed.

Liabilities and Assets. The chief liabilities of banks in Australia, other than deposits, are capital and reserves, and bills in circulation. The total reserves fall little short of paid-up capital for the banks as a whole, while bills in circulation are not a great sum in the aggregate at any time. Of the assets " discounts, overdrafts and all other assets " represent advances and are over 75% of the total. The remainder are chiefly cash reserves (gold coin and bullion and Australian notes), municipal and government securities, bills of other banks, and bank premises and land. Cash reserves and advances account for nearly 90%. But this does not give a clear picture of the total assets of a typical Australian bank with headquarters in London, or an important branch there. The following is a summary statement of the chief items in the balance sheets of Australian banks. It

is taken from *Teare: Australian Banking Currency and Exchange* (pp. 90–1), and refers to an imaginary bank — the United Bank of Australia. London and New Zealand balances are included.

(Figures in millions)

Liabilities	£	Assets	£
Paid-up capital	4.00	Cash Balances and bullion	7.87
Reserves and undivided profits	3.59	Money at call in London	3.88
Bills payable	1.27	Bills receivable at London and in transit	2.84
Deposits	36.20	Investments in public securities	3.03
		Bills discounted and advances	26.45

The chief interest of this statement is the classification of assets. All the items except the last are comparatively liquid. Even investments in public securities may be quickly realized. About half of these securities are British Government Bonds and this item together with "Money at call in London" has an interesting place in the balance sheets of all important Australian banks. Funds are kept in London for the purpose of exchange business in which the banks play a leading part. The amount of these funds depends upon the balance of payments, a favorable balance augmenting them and an unfavorable balance diminishing them. There is also a close connection between these funds and the movements of advances and deposits in Australia, as will be disclosed when discussing exchange transactions. The organization of the British money market enables the Australian banks to hold substantial balances in London and this strengthens the whole monetary system of the Commonwealth.

Banking Functions: Financing Industry and Trade. The preceding outline of the assets and liabilities of Australian banks suggests the main functions performed by these banks. It is not necessary to describe the minor services performed by banks in all countries, nor to deal with such a traditional function as the receipt of deposits. The Australian banks undertake these services in the normal course of their operations. The two important functions which require special mention may be stated as (i) the financing of industry by means of advances, and (ii) the financing of trade both internal and external by the discount-

ing of bills and the issue of bank drafts. Reference has already been made to the second function in describing the credit instruments in use, and it must again be discussed in dealing with the exchange system. The financing of external trade is largely a banking function in Australia and each bank has an important Bill Department. In some banks there is also a Shipping Department for the purpose of arranging the shipping documents for produce against which the banks have made advances, or discounted bills. But these services may be performed also by the Bills Department, which is concerned with the issue and discount of bills of exchange. All the detailed work of forwarding bills for collection abroad, of handling bills received from abroad and of discounting bills is carried out by this department. Australia has no free exchange market, but the banks undertake practically the whole of the exchange business. In times of special difficulties the importers and exporters adopt various expedients for avoiding heavy charges, such as the purchase and sale of foreign securities, or direct dealings against funds held locally or abroad by individuals or companies. Nevertheless it is correct to say that the banks have virtually a monopoly of the exchange business. Further, practically all external payments are arranged through London and the banks accept the London exchange rates when doing business with foreign countries. In their exchange business the banks may deal directly with the producer, but in other cases they stand behind the special firms, such as pastoral and finance companies, which arrange the sale of rural production. The former method is more common in the import trade and the latter in the export trade. In the case of imports the bank arranges payment by means of a draft against the importer's check, or the foreign exporter may draw on the importer, if the latter's credit is assured either by his own standing in business or by letter of credit from his bank. In the export trade the pastoral companies secure advances against the shipment of goods, or they may have bills discounted with the banks, leaving the latter to collect from the foreign purchaser. In whatever way imports and exports are financed the banks play a leading rôle, either by way of supporting firms especially engaged in this trade, or themselves undertaking much of the detailed work.

Advances and the Money Market. Banks also arrange for inter-state payments and quote special rates for this business. This is done mainly by the issue of drafts. Debtors may also remit by check, the bank charging exchange on the transaction. Thus, between Melbourne and Sydney the charge is 2/6d. per cent while between Brisbane and Perth it is as high as 12/6d. per cent. In a country like Australia where distances are great and settlement is as yet comparatively sparse the financing of inter-state trade imposes a strain upon banking resources in some centers. The movement of goods is mainly away from the big centers like Sydney and Melbourne to which the smaller centers are always heavily indebted. In financing this trade, banks render a useful service. While it is a convenience to the extent that funds accumulated in some centres may be used for the purpose, it imposes an obligation upon banks to distribute their funds in such a way as to meet the claims of their inter-state clients.

The large preponderance of "advances" in the assets of banks is sufficient evidence of the degree to which banks make credit available for home industry. It is impossible to state the proportions in which advances are made for various purposes. A large proportion of advances is, however, against rural properties. A small amount is advanced to manufacturers against goods in the process of production or on sale, and to pastoral companies against goods on sale. The advances are mostly granted through an overdraft, giving the client the right to overdraw his account to a fixed amount. In a few cases, e.g., public bodies, the bank grants a loan for a fixed period at a lower rate of interest than is demanded for overdraft. But, for rural producers, this method of finance is usually left to pastoral companies and State banking authorities. Manufacturers, in the main, obtain sufficient funds through their shareholders' capital, and use the overdraft only as a convenience for their mercantile operations. The rate for overdraft is higher than discount rate and is usually about 2% higher than the average rate allowed on deposits. Banks accept as collateral land and real estate, merchandise on sale or in process of production and approved securities. In some cases well-known clients of high standing may have a general right of overdraft to a prescribed amount without any secu-

rity being specified, though the bank may reduce the overdraft at any time. The system of overdraft gives the borrower the right of reducing his obligation at any time and supplies him with adequate trading capital, though the interest rates are higher than they would be under a system of fixed loans. On balance there is probably an advantage to the borrower under the system. It is favorable to the banker in that it makes his securities more liquid and he is able to control his advances at any time by reducing the overdraft limit.

Banks also grant overdrafts to municipal and local public bodies. This is the usual form of assistance where the need is temporary, but where a long period loan is required banks may advance the money, taking as security " the service of some special rate upon which debentures have been issued." Another form of investment for banking funds is the Government loan. But only a small percentage of the total assets of the banks are invested in such public securities, most of these issues being taken up by insurance, trustee, and investment companies, or by private investors who arrange the purchase through their bank, or through a stock broker.

At the close of the war and after, the banks assisted in the flotation of war loans by allowing their clients to take up heavy investments in loans on an instalment purchase system, but this type of financing is not extensively done in ordinary circumstances, though the banks receive applications for investments in public securities from their customers. There are no large specialised underwriting firms in Australia concentrating on the underwriting of loans, and the investment market is not yet developed as it is in older countries. Stock brokers assist in the flotation of loans as part of their functions and the attitude of the stock exchange is often the vital factor determining whether a particular issue is likely to succeed. There are always large parcels of Government, municipal, and well-known private securities available for purchase and the market for these is well organized through the stock exchange. In practice the banks underwrite Government issues, the insurance companies municipal loans, and the stock brokers industrial loans. But there is at present no organized short loan market in the American, and still less in the British sense of the term. Public securities are looked

upon as the best forms of short time investment but banks do not avail themselves of the limited facilities for such investment except in a small degree for the satisfactory placing of their reserves. This is not true of the Commonwealth Bank which holds a large part of its assets, mainly on account of Savings Bank business, in the form of public securities. As the discount market is entirely in the hands of the banks, and Australia is still dependent on the British bill of exchange for the financing of external payments the trend of development in the short loan market is likely to be in the direction of public securities and well-known stocks as is the case in America. Banks do not at present make available any considerable portion of their funds for this work, but there are other large financial institutions with floating balances from which stock brokers may obtain funds for such operations, and this is probably the source from which funds for short term investments will be derived.

THE FOREIGN EXCHANGES

In a previous section it was shown that the banks directly financed the foreign trade of Australia through their shipping and bill departments. It is now necessary to describe the nature of their exchange dealings and to examine the effects of these operations on the monetary system. The banks publish buying and selling rates for exchange on London. These rates vary from time to time according to the distribution of their funds between London and Australia as determined by the balance of payments. There are no day to day fluctuations and the banks apparently resist any serious difference between the values of the British and Australian currency units. Below is given a typical statement of the rates quoted:

Australian Exchange on London

Buying s. d.	*Dec. 4, 1925*	*Selling* s. d.
5. 0% discount	T.T.	Par.
20. 0 "	O.D.	7. 6 discount
22. 0 "	3 days	— –
30. 0 "	30 "	15. 0 "
40. 0 "	60 "	22. 6 "
50. 0 "	90 "	— –

In this case the rates are favorable to Australia. Thus for the telegraphic transfer the bank will buy or discount the exporter's bill of £100 on London for £99. 15. 0. in Australia, and will provide a £100 draft or bill on London at par in Australia. In the T.T. rate there is no question of interest, the other rates differing from it by the margin allowed for interest at the current rate of discount, which in the buying rate is usually about 1½% above the average rate on deposits and ½% below the rate on overdrafts. The margin of 5/– between buying and selling rates for T.T. representing the banker's profit, is lower than had been customary up to the restoration of the gold standard early in 1925. The 12/6 difference between buying and selling for the On Demand rates is nearer the normal margin of profit. This is also the normal difference between the selling rate in Australia and the buying rate in London. Thus the banks announce their rates in London for buying exchange on Australia as 17/6% discount for sight bills, 27/6, 37/6, 47/6 respectively for 30, 60, and 90 day bills. Taking the 30 day bill it will be observed that the British exporter will cash his £100 bill in London for £98. 12. 6. If the importer paid by draft on London he would be required to deposit £99. 5. 0. in Australia for £100 in London. The difference in what the bank pays at London in the first case, and receives in Australia in the second is 12/6, and represents the margin of profit.

There is no free exchange market in Australia. The banks accept the rates on foreign countries ruling in London and fix their rates with London according to the state of their cash balances in London. But there appears to be a general desire to maintain rates at or near parity. Only in exceptional circumstances do the rates move far from parity. Even then the variation is not so great as the balance of international payments or the differences in Australian and British price levels would suggest. This matter is further discussed below. It is noted here by way of emphasizing the control exercised by the banks over the exchange situation, and their view that an independent exchange market and free movements of rates are not necessary. This is partly a legacy from early banking history when the banks were established in London with Australian branches, or vice versa, and partly the result of a natural assumption that the English and

Australian currency units are identical in value. It emphasizes the close dependence of Australian upon British banking, and the desire of Australian bankers to maintain the connection. The importance of this attitude will be obvious in the discussion which follows concerning the effects of exchange operations upon the flow of credit in Australia.

Currency and Exchange. The traditional statement of the effect of the exchanges on currency and credit was as follows. Assuming that prices were rising in Australia more than in England, or that Australia had an unfavorable balance of payments with England, exchange rates would move against Australia until they reached the exporting specie point, i.e., the point at which it would be more profitable for importers to ship gold than to purchase drafts on London in settlement of their debts abroad. Gold would therefore be exported and this would reduce bankers' reserves in Australia. A contraction of credit would follow, imposing a reduction in the spending power of the community and a consequent recession in prices. Two consequences of importance to foreign trade would then appear. First, the falling price level in Australia would reduce imports because the market would be less advantageous to sellers. Exports would increase for the opposite reason. Secondly, the adverse exchange rates would assist exporters whilst discouraging importers. Hence the international balance of payments would be restored and the price levels of Australia and Great Britain again reach a common level. Exchange would return to par and gold movements would cease until a similar or converse situation arose.

In addition to these automatic corrections to undesirable price and trade movements it was argued that the gold standard gave the necessary elasticity to currency, and always provided additional cash when it was required, whilst also imposing restrictions when they were required. Thus, in a favorable exporting season banks were free to negotiate bills because they could "transfer" their funds from London, and thus obtain sufficient cash for reserves in Australia. Under such conditions credit expansion was allowed and the currency was elastic. On the contrary, if imports were heavy and banks found it necessary to pay out funds in London on behalf of their Australian clients, they could always procure sufficient cash for their London reserves by

the simple expedient of obtaining gold there or shipping it from Australia. This would cause a contraction of currency in Australia, at a time when excessive importing demanded it. Such expansion and contraction of credit and currency in Australia was a prominent feature of pre-war banking conditions.

In this statement the emphasis is upon gold movements which were on a very small scale prior to 1913. Owing to the cash balances held by Australian banks in London and the profitable use that they could make of such balances at most times shipments of gold for exchange purposes were rarely required, and the Australian monetary connection with Great Britain closely resembled the gold-exchange system. This may be shown by an analysis of the movements of credit in Australia in relation to the balance of international payments. First, a brief explanation of the effects of exchange operations on deposits is necessary. The position may be summarized as follows: — In financing exports and imports banks increase or decrease the deposits of their customers in Australia. Thus the exporter's bill entitles him to increased credit with the bank in Australia, whilst the importer's draft is purchased by a check upon his account at the bank and leads to a reduction of banking deposits in Australia. Hence exports increase and imports reduce bank deposits. The one leads to a heavier drain upon bank cash reserves in Australia, while the other increases the proportion of reserves to deposits. It follows, therefore, that banks cannot deal with a heavy excess of exports over imports without possessing substantial cash reserves in Australia. That is the vital point for the banker at this end. In London the position is reversed. Imports involve a drain upon the London funds of Australian banks, whilst exports replenish them. The bank gives its customer (the exporter) credit in Australia for the right to receive the proceeds of the bill in London. Conversely, the bank accepts its customer's (the importer's) check in Australia and cancels his deposits, but in return undertakes to pay out on his behalf cash in London to the person from whom the importer has purchased his goods. Bank funds in London, therefore, fluctuate according to the ratio between exports and imports. The banks cannot finance a heavy excess of imports over exports unless they have ample funds in London. That is the vital point for the banker at the London end.

Banking Funds and the Balance of Payments. This view of the problem places due emphasis upon the movements in bank funds, and suggests that gold imports or exports were needed mainly for the purpose of sustaining these funds. The banking situation in Australia would thus be influenced mainly by the nature of the balance of payments. When this balance is favorable to Australia there will be an expansion of credit here; in the opposite circumstances credit will be contracted. The matter can be tested. For any bank there should be a close connection between the cash balances it holds in London and the excess of deposits over advances in Australia. The latter is taken because exports increase the margin between deposits and advances, and imports reduce this margin. This may be demonstrated in the figures for the Bank of New South Wales which the student will find move in conformity with each other over nearly the whole period from 1903 to 1924. Of twenty-three movements covered in the series all but three are in the same direction, and the three abnormal years were 1915–16–17, when the great war inflation in Australia led to an undue expansion of deposits. Another means of testing this explanation is to take the net balance of international payments in relation to the excess of deposits over advances in Australia for the banks as a whole, taking the figures for the years 1914 to 1924. Here again the connection is obvious. In all but one year the movements are in the same direction, and the exception is the difficult year of 1924, when the banks were forced to restrict credit despite an increase of funds in London. It may therefore be assumed that the most important controlling influence in Australian banking is the balance of payments and the flow of bank funds in London. Gold is used only to sustain movements in banking and credit, set in motion by this controlling influence. During the war when free gold movements were impossible the exchanges were kept remarkably stable despite serious differences between the British and Australian price levels, and considerable variations in the balance of payments. This was due in part to the special financial measures adopted by the British Government for purchasing Australian produce and assisting the Commonwealth Government. With an independent exchange system the rates must have fluctuated greatly, for in fact the Australian pound dif-

fered very greatly in value from the British pound. It is not easy to measure the exact variations in purchasing power of the two currency units, but the index numbers of wholesale prices offer some guidance. The following figures for wholesale prices are taken from the Commonwealth Statistician's Labor Report, No. 13, p. 150: —

Year	Great Britain (Board of Trade)	Australia
1901	883	974
1907	969	1021
1911	1000	1000
1913	1065	1088
1918	2443	1934
1920	3343	2480
1922	1691	1758

In pre-war times the two price levels moved together and showed slight differences only, but after 1913 the British price level fluctuated much more violently than the Australian. A chart would show the British level far above that of Australia in April, 1920. Two years later British prices had fallen more than Australian, and since then there have been diverse movements. In these circumstances variations in exchange rates should occasion no surprise; rather we should wonder that the exchange rates were so stable over the whole period.

This comparative stability was due to the long-established relation between British and Australian banking and the traditional view that the two currency units were identical. Even without the common basis of gold, and in spite of the abnormal conditions imposed by war finance, the expansion and contraction of credit and currency proceeded as in pre-war days. During heavy exporting seasons there were always ample cash supplies in Australia, thanks to the volume of the note issue. At the other end, the borrowing of Australia and the great demand for primary products during the war gave sufficient credit. Thus, in the absence of gold movements, Australian currency was regulated largely in a normal way by the banks. It is true that on a few occasions, notably in 1921, when there was a stringency of Australian cash in London, and in 1924 in opposite circumstances, the system showed signs of strain that were not in evidence before the war. The difficulties experienced at these times

gave rise to a strong presumption in favor of gold, but we may well ask the question whether the war experience, the special conditions of Australian exchange and recent changes in banking and exchange, do not suggest that some other arrangement might give all the advantages of the gold standard.

These questions are considered in the final section dealing with the position of the central bank. It is only necessary to add that the close financial connection with England, sustained as it is by the banks and the policy of public borrowing in the British money market, makes the Australian exchange system closely dependent upon Great Britain. There is no evidence that the position of dependence is likely to be changed in the near future. Australia at present finances most of her external payments through London and accepts the prevailing rates of exchange ruling in London. There is thus no independent exchange market in Australia and the rates of exchange vary only occasionally as announced by the banks after agreement with the Commonwealth Bank.

THE COMMONWEALTH BANK

Origin and Growth. Established in 1912 the Commonwealth Bank soon rose to an important position in the banking system of Australia. It is the boast of the member of the Federal Labor Party who was mainly responsible for the idea of a State bank that it is unique in the history of banking inasmuch as it was organized without capital. Power was given to raise capital to the value of £1,000,000, but this was not used. The losses on early transactions were debited to the profit and loss account, and amounted to £46,637 at June 30th, 1913. This sum was steadily reduced and at the same date two years later had been turned into a small profit of £2,221. The Bank had the authority of the Government behind it and commenced operations with deposits to the value of £2,341,720, consisting of funds belonging to various departments of the Commonwealth Government. A Savings Bank Department had been opened in the middle of 1912 and was able to make use of the post office facilities of the Government, the States being advised that these facilities would no

longer be available for their institutions. It was proposed by the Commonwealth Government to take over the savings bank business of the States, but after lengthy discussions on the matter it was not possible to come to any agreement. The Commonwealth Bank, however, took over the Tasmanian State Savings Bank in 1913, and the Queensland Savings Bank in 1920. With the Government account and the savings bank business the Bank was in a good position to make an effective start, and when the war broke out a further advantage was afforded it in the increasing use made of the institution by the Government. The total profits at June 30th, 1920, were £2,765,105. Four years later, before the important legislation of 1924, the profits had risen to £4,654,673 and the Bank had established its authority through the substantial services it had rendered to the Government in war and repatriation finance under the management of its first Governor, Sir Denison Miller.

Under the original Act of 1912 the Bank was given power to carry on the ordinary business of banking, to enter upon savings bank business, and to open branches in Australia. The Bank was not to issue notes, and this prohibition was maintained till 1920 when the Note Issue Department was established, and the Australian notes, previously issued direct from the Treasury, placed under the authority of the Bank through a board of which the Governor was chairman. The Bank was originally managed by a Governor and Deputy-Governor appointed by the Government but independent of political control, a provision which was successfully maintained. There were at first the two departments providing for savings bank business and ordinary business. In 1920 a Note Issue Department was established and in 1925 a Rural Credits Department was added. The attitude of the Bank in undertaking the well-established functions of banking and adopting a cautious policy has added greatly to its strength as a central bank which must in the nature of things undertake only restricted commercial functions. It is the savings bank business and the Government account that is responsible for the rapid progress of the Bank and the exigencies of war finance have also been a great stimulus. The Bank holds, in addition to the Commonwealth's account, the accounts of the States of Queensland, South Australia, Western Australia, and

Tasmania. It also has the accounts of a great many local bodies. This concentration on public accounts has not involved the Bank in competition with the commercial banks for private accounts. It has indeed been the policy of the Bank not to attract business from the other banks by offering special inducements to customers. Thus the Commonwealth Treasurer in introducing the amendments to the Act in Parliament in 1924 stated — " Indeed it is understood that the policy of the management up to the present has not been to enter into active rivalry with the trading banks. . . . It is fortunate the policy has been such as has been described because by reason of that policy the conversion of the Commonwealth Bank into a central Bank has been rendered easier."

Before passing to an analysis of the present functions and organization of the Bank some reference should be made to the war services it rendered. More than anything else these services have given the institution its present authority and high place in the mechanism of Australian banking. The most important of its war services were the arrangements it made for the raising of war loans in Australia, a country hitherto quite unacquainted with the flotation of large security issues. In this work the Bank and the Government received the active and wholehearted support of the private banks and there was built up a valuable working alliance between the Bank and these institutions. At June 30th, 1923, seven war loans and ten peace loans had been raised in Australia, the aggregate subscriptions to which were no less than £250,000,000. The total cost of floating these loans was only a little over £700,000, or less than one-third per cent. In arranging for financing the special pools through which Australian products were sold during the war the Bank also undertook financial operations of the first magnitude. Advances on produce were made on a very large scale and it is estimated that the pools handled funds to the value of £430,000,000 in all. Many minor services were also rendered, such as the establishment of branches and agencies to deal with the disbursement of army pay and soldiers' remittances to and from Australia, the cashing of war gratuity bonds, and the handling of patriotic funds. All these services would have been performed equally readily by the other banks had the Commonwealth Bank

not been in existence, but it was a great convenience to the Government to have the use of the special facilities offered by the Bank. It is obvious too that the Bank greatly profited by the large volume of this work.

The Banking Act of 1924. Thanks to the opportunity afforded the Bank during and after the war, to the policy of the first Governor and to the legislation passed in 1920 creating a Note Issue Department, the Bank had by 1924 reached a powerful position in the banking system of Australia. In this evolution the Act of 1920 is important, for it placed the whole of the assets and liabilities of the note issue under the Bank and created a Notes Board independent of the Government. In addition it authorized the issuing of notes against trade bills of not more than 120 days' currency and thus made provision for a discount and re-discount policy, if the Notes Board thought such a policy necessary. From 1920 to 1924 the Notes Board had complete authority over the note issue. These were critical years in that they ushered in the great deflation movement which followed the post-war boom. This was followed by an abnormal exchange situation during 1923 and 1924 when the private banks complained of a shortage of cash reserves in London. The Notes Board was urged to increase the issue, but gave only temporary relief under stringent conditions. Meanwhile the death of Sir Denison Miller raised the question of the future control of the Bank. Out of this situation arose the Commonwealth Bank Act of 1924 which made substantial changes in the management of the Bank. These may be summarized as follows:

(i) The appointment of a Board of Directors.
(ii) The abolition of the Notes Board and the control of the note issue by the directors, and the right to issue notes against gold and securities in London.
(iii) The provision for increasing the capital of the Bank.
(iv) The granting of power to the Bank of fixing and publishing discount and re-discount rates.
(v) The settlement of clearing house operations by the private banks through the Commonwealth Bank.

All the above measures were carried through and they constitute a new charter for the banking system of Australia. By compelling private banks to use checks upon the Common-

wealth Bank for settling their clearing house operations, it was hoped to strengthen the position of the Bank. Capital to the amount of £10,000,000 was authorized and was to be provided through the issue of debentures for £6,000,000 and the appropriation of £4,000,000 from accumulated profits. The policy of the Bank was handed over exclusively to the new Board which also had complete authority over the note issue subject to the arbitrary power of the Commonwealth Government in times of stress. No conditions as to policy are prescribed in the Act, though the Treasurer indicated that the Bank might develop important re-discount operations. He anticipated that the private banks should be able to procure sufficient cash from the central bank during the export season to enable them to accept their customers' bills. "One of the most important functions of a central bank," he claimed, "is that of re-discounting, by means of which, under all ordinary circumstances, every other bank is able to convert its bills of exchange into legal tender money."

The Bank has been operating under this new charter since October, 1924. The chairman of the old Notes Board was appointed chairman of the new Board of Directors, and one of the first acts of the latter was to enter into an agreement with the commercial banks to undertake a due share of the financing of the export trade and to provide additional notes if required. This at once relieved the situation described above and placed Australia in a position to return to the gold standard as soon as Great Britain was ready for this important step. The present Board of Directors consists of the Governor and seven other directors. The Secretary to the Commonwealth Treasury must be a member of the Board and the remaining six must be, or have been, engaged in agriculture, commerce, business, or industry. The offices of Governor and Deputy-Governor as prescribed in the original Act are to be filled by the Governor-General of the Commonwealth. In practice, of course, the Board will be asked to give advice on the selection of these officers. Both officers are appointed for a period not exceeding seven years, and are eligible for re-appointment. The Board of Directors decides matters of policy and acts as an intermediary between the commercial banks and the Bank. This is an important provision, guaranteeing as it does a coördinated policy

between the central bank and the other banks. Under its new management the Bank is likely to concentrate more than ever upon the functions peculiar to a central bank, though it must be remembered that the Bank still has a large savings bank business as well as the newly constituted Rural Credits Department. This renders the Commonwealth Bank unique among the central banks of the world, as also does the fact that it is a Government institution. The Board of Directors has power under the Act to appoint a London Board of Advice, consisting of three members, for the purpose of representing the Bank in its negotiations with British and foreign banking and financial authorities, and for such other purposes as the Board may direct.

The Bank Statement. A financial statement of the Bank is published quarterly in the *Commonwealth Gazette*. For purposes of analysis the statement for September 30th, 1925, published in the *Gazette* on December 17th, is given.

Liabilities			
Capital account	£4,000,000	0	0
Reserve fund	696,608	8	7
Deposits	38,937,645	5	0
Bills payable and other liabilities	6,288,773	17	3
Savings Bank Department — Depositors' balances	42,401,772	16	11
Total general bank and Savings Bank departments	92,324,800	7	9
Note issue department	53,890,226	10	0
Rural credits department	68,474	0	0
Total	£146,283,500	17	9
Assets			
Coin, bullion and cash balances	£10,898,120	12	10
Australian notes	10,976,738	0	0
Money at short call in London	17,305,000	0	0
Investments — British, Colonial and Government securities (face value, £39,595,777 3s 9d)	39,432,021	1	3
Fixed deposits, other banks	954,000	0	0
Bills receivable, bills discounted, loans and advances to customers, and other sums due to the bank	11,778,710	9	6
Bank premises	888,308	0	0
Total general bank and Savings Bank departments	92,232,898	3	7
Note issue department	53,890,226	10	0
Rural credits department	68,474	0	0
Total	£146,191,598	13	7

The capital is still only £4,000,000, representing the amount transferred from accumulated profits when the management of the Bank was changed. The right to issue debentures to the value of £6,000,000 has not yet been exercised. According to the Act half of the net profits is to be placed to the credit of the "Bank Reserve Fund." This explains the item reserve. The remainder of the profits is to be paid into the National Debt Sinking Fund. Of the other liabilities it is only necessary to refer to the note issue, which stood at the amount of the liabilities of the Note Issue Department, and to the provision for rural credits which appears in the balance sheet for the first time on this occasion. The small liability is either a Treasury advance or a transfer of profits from the Note Issue Department according to the authority given the Bank under the Rural Credit Act.

The quarterly averages of the weekly statements of assets and liabilities give the latter in a different form. An item — "Balances due to other banks" amounting to £4.76 mills. for the September quarter of 1925 shows the influence of the new system of clearings settlements by checks on the Bank. In the above statement this item is evidently included in "Bills payable and other liabilities." The division of deposits excluding deposits in the Savings Bank Department into those bearing and those not bearing interest reveals the proportion of the latter as 72% of the total, a much higher figure than is found in the returns of commercial banks.

Of much more significance is the distribution of the assets. In the ordinary banking department and the savings bank it is important to note the small proportions of assets represented by advances. The first three items are good liquid securities, and it is especially interesting to find that the Bank holds such a large proportion of its assets in "money at short call in London." This again shows the close connection between the Australian and the British monetary systems. The item "fixed deposits of other banks" apparently represents a small sum deposited with other banks. The other banks do not, however, hold cash with the Bank for amounts over and above those required for clearing operations. The heavy investments in public securities are partly on account of the deposits of the savings bank, but the

ordinary funds of the Bank are invested in this way to a much greater degree than is the custom with the commercial banks. Taking the general bank and savings bank departments the proportion of cash reserves to liabilities (excluding capital and reserves) is 44 per cent. In this statement cash reserves are taken to include the first three items of assets, which may be set out again as follows: —

Coin, bullion and cash balances	£10.9 mills.
Australian notes in the general bank department	11.0 "
Money at short call in London	17.3 "
	£39.2 mills.

Over 40% of this reserve is held in London, but this will not be a fixed proportion since it will vary with the state of the balance of international payments. At the time of this statement the balance was slightly in favor of Australia, and as there has been no experience of an unfavorable balance it is not possible to state what will be regarded eventually as a satisfactory proportion of London cash balances. The gold held against the note issue was 48.5% of the total issue and 108% of the amount of notes in the hands of the public. With reserves of this nature the Bank is in the best tradition of central banks. To complete the statement of assets and liabilities the investments on account of the uncovered portion of the notes should be stated. At June 30th, 1924, there were £30.8 mills. uncovered, of which £8.6 mills. was held in Commonwealth Inscribed Stock, £13.1 in Treasury Bills of the States, and the remainder in State Government Stocks. These investments may be regarded as comparatively liquid, and they would prove useful if the Bank at any time found it necessary to control the money market through an open market policy of buying and selling public securities as is done in the United States and Great Britain. Such a policy has not yet been attempted on a systematic scale by the Bank, and it is probable that it would use its investments in the ordinary banking department for this purpose. The financial statement shows that it is well equipped for such operations. At the present time, however, the Bank regards it as more important to maintain a satisfactory exchange position with England and in the existing circumstances this is all that is necessary.

Its Position as a Central Bank. The Bank is authorized by act to fix and publish the rates at which it will discount and re-discount bills of exchange. The provision for re-discounting is an innovation in the Australian banking system, and it has not yet been exercised by the Bank. Other steps have, however, been taken to meet the same object, and when the practice of re-discounting becomes more familiar it will doubtless be adopted. After the restoration of the gold standard it was arranged by the Commonwealth Bank to issue notes against gold held by the commercial banks in London, provided this gold was set apart for this special purpose in an account at the Bank of England. It was thus possible for the banks to discount their customers' bills and to obtain sufficient cash in Australia to conduct their ordinary business. But the same purpose would have been achieved if the Commonwealth had re-discounted the bills presented by the other banks and collected the gold in London from their branches. Notes would have been issued in Australia against the bills so presented, and the currency would have expanded as it did in similar circumstances under the free operation of the gold standard. The fact that this system was not adopted despite the authority of the Bank under the Act, shows the state of transition through which the banking system is passing, and serves also to emphasize the developments required before the Commonwealth Bank will establish its authority completely as a central institution. As the Bank has absolute control of the note issue it is, however, in a position to enforce its discount policy and to maintain fairly stable exchange rates between Australia and London. This is comparatively easy when the balance of payments is favorable to Australia, for all that is required is that notes be issued against gold in London, or that the Bank issue notes against bills presented for re-discount in Australia. The latter policy should prove easy to follow as soon as the banks can agree as to its wisdom. Under the Act the Bank is empowered to issue notes against trade bills and it would be within its competence to undertake re-discounting operations. But the position in a time when the exchanges were against Australia is not so obvious. The responsibilities of the Bank would be much greater, for it would have to provide remittance on London at all times at fixed rates, and would thus

have to maintain large cash balances in London. There is no doubt that the Bank could do this if the position arose and such action was thought necessary. As already indicated it holds large cash or liquid balances in London and has investments in British Government securities. The practice of borrowing in London by Australian Governments would in a time of adverse exchange add to the funds available to the Bank for exchange operations. The Bank could thus undertake to sell bills on London in exchange for cash in Australia at fixed rates approximating to the export specie point. The other banks would only use this right of procuring remittance abroad at a time when the resort to a premium on drafts to the limits set had not proved effective in checking imports. If the Bank cancelled all notes received in purchase of such remittance its action would be as effective as an export of gold under the normal operations of the gold standard. Such cancellation would be automatic if the notes were issued against bills of exchange or balances in London, as the Act provides. It is quite impossible to say whether such a system will be adopted. There are no signs of it at present and only the actual experience of an acute exchange crisis would enable anyone to observe the trend of development. Such a scheme would be in conformity with the suggestions of many experts who think that the gold exchange standard should be adopted by all countries whose monetary system is dependent upon that of some leading country. At the present time the arrangements for issuing notes against gold in London is a step in this direction. But this was not intended to be the fore-runner of a complete gold exchange standard. Its adoption was due to the special circumstances obtaining at the time of Australia's return to the gold standard. There was a danger of considerable exports of gold from England to Australia, and the special arrangements were made for the purpose of providing adequate cash in Australia without imports of gold. This would not in any way embarrass England and it would meet all the requirements of Australia. It has been shown in the section on the exchanges that currency and credit in Australia expand and contract according to the balance of international payments, and it is clear that both the special arrangements made, and the suggestions outlined above for the adoption of a type of gold ex-

change standard are in keeping with the monetary system of the country.

It is too early to say along what lines the Commonwealth Bank will develop as a central bank. While Australia follows British policy there is little or no need for an open market policy on the part of the central bank. The price level is definitely tied to that of Great Britain, and as long as the latter does not show abnormal fluctuations, Australia is relieved of the necessity for an independent monetary policy. But within these limits there is ample scope for a strong central bank. The Commonwealth Bank is well fitted for such a development. It has very little ordinary commercial banking, it has complete authority over the note issue, its assets are substantial and suitably invested in liquid securities, and under its new constitution there is provision for coöperation between it and the other banks. Its immediate task is to work out a satisfactory re-discount policy and to arrange for an elastic note issue that will give all the advantages of the gold standard without gold movements. It may be expected that this task will occupy the attention of the new Board and that there is no thought at present of embarking upon an independent policy requiring the exercise of open market function.

ADDENDUM

The above chapter was completed in February, 1926. In the ensuing twelve months the author was absent from Australia and it has been impossible to make the necessary corrections in the proofs to allow for some important developments that took place in the early part of 1927. As the chapter could not be considered complete without mentioning these, the following notes are inserted. Readers will readily relate the topics mentioned to the treatment in the chapter.

(i) In the first place three important amalgamations took place early in 1927. The English, Scottish and Australian Bank (London) absorbed the Royal Bank of Australia (Melbourne), the Commercial Banking Company of Sydney absorbed the Bank of Victoria (Melbourne) and the Bank of New South Wales (Sidney) took over the Western Australian Bank (Perth). The important features of the financial position of these banks in the last half of 1926 is shown in the following table — (figures in thousands): —

	Capital Paid up	Reserve Fund & Undivided Profits	Deposits, Notes & Bills in Circulation	Total Assets
	£	£	£	£
English, Scottish & Australian....	2,250	2,281	32,439	37,253
Royal Bank of Australia.........	750	694	5,843	7,324
Commercial Banking Co..........	3,500	3,055	38,539	47,099
Bank of Victoria..................	1,478	889	12,241	16,730
Bank of N. S. W.................	6,000	4,880	58,588	79,079
Western Australian Bank.........	700	1,311	2,959	5,104

In all cases the resources of banks already substantial have been materially strengthened and the tendency towards concentration further developed. The number of banks with headquarters in London or Australia is now only 15, and the nine leading commercial banks account for nearly 95% of the total paid-up capital of the commercial banks as a whole.

(ii) Whilst it is too early to record anything definite concerning the development of central banking in Australia there have been important discussions on the subject. Early in 1927 Sir Ernest Harvey, Comptroller of the Bank of England, visited Australia at the invitation of the Commonwealth Bank. At a series of conferences with the Board of Directors of the Bank, Sir Ernest Harvey had the opportunity of discussing the position of the Commonwealth Bank as a central bank. He also had conferences with the commercial banks. No official announcement has been made concerning the details of these discussions, but they were reported to have included the centralization of the gold reserves, the development of a discount market, and the trading and savings bank functions of the Commonwealth Bank. On the first of these a pooling of gold reserves under the control of the Commonwealth Bank would promote an economy in the use of gold in Australia, enable a greater proportion of the reserve to be held in London and facilitate exchange transactions. In the second case a decline in the use of overdrafts as a means of making advances by the commercial banks and a more frequent resort to the practice of discounting bills would facilitate the development of the practice of re-discounting by the Commonwealth Bank. Sir Ernest Harvey was rather outspoken in his preference for the commercial bill as opposed to the system of over-drafts familiar in Australian banking practice. A combination of these two measures — pooling of gold reserves and the establishment of a discount market — would provide a satisfactory basis for the exchange system (a form of gold-exchange standard) suggested in the final section of the above chapter. It is impossible to state at present whether progress will be along these lines.

On the third problem — the trading functions of the Commonwealth Bank — there is a considerable body of opinion in support of the contention that a central bank should indulge in very restricted commercial operations. This, however, is contrary to the policy of important political groups who would maintain the savings bank department and extend the rural credits department of the Bank. No clear line of policy has yet been enunciated on this important point and it is doubtful whether the commercial banks would encourage the development of the Commonwealth Bank into a strong central bank even if it abandoned its other main activities. This again demon-

strates the period of transition through which the Australian banking system is passing and the impossibility of making any final pronouncements upon it.

(iii) The Commonwealth Bank commenced in July to publish a new form of weekly return on the same lines as the Bank of England. It does not contain figures relating to the savings bank or rural credits departments. The returns for two weeks in September, 1927, were as follows:

NOTE ISSUE DEPARTMENT

	Sept. 5	Sept. 12
	£	£
Liabilities —		
Notes Issued	48,393,226	48,393,226
Property Reserve Account	224,023	228,014
Total	48,617,249	48,621,240
Assets —		
Gold Coin and Bullion	20,721,001	20,721,001
Debentures and Other Securities	25,100,423	25,100,423
Other Assets	2,795,825	2,799,816
Total	48,617,249	48,621,240

GENERAL BANKING DEPARTMENT

Dr.	Sept. 5	Sept. 12
	£	£
Capital and Reserve Fund	4,147,809	4,147,809
Deposits	35,044,853	38,063,947
Bills Payable and Other Liabilities	2,575,909	2,699,999
Total	41,768,571	44,911,755
Cr.		
Coin and Bullion and Cash Balances	2,799,663	5,955,334
Notes	7,446,109	7,386,908
Money at Short Call in London	5,159,000	4,239,000
Government and Other Securities	10,458,705	10,458,705
Discounts, Advances, &c.	13,357,070	14,508,190
Bills Receivable and Other Assets	2,548,024	2,363,618
Total	41,768,571	44,911,755

Whilst this form of return has the merit of presenting the salient features of the note issue and general banking departments it does not add to the information given in the return quoted in Section VI. above, or give a complete picture of the assets and liabilities of the Bank as a whole. The chief value of the new return will lie in its provision of up-to-date information upon deposits and advances at the Bank, total liquid reserves, and the proportion of these reserves held in London.

(iv) Reference should be made to an analysis of bank advances given by the Chairman of the National Bank of Australia in his annual speech in May last. The proportion of overdrafts was as follows:

	Percentage of Total Overdrafts	Average Overdrafts
Primary Producers	40.4	£ 780
Secondary Industries	3.7	£3580
Personal and Professional	28.3	£ 429
Mercantile	24.7	£1053
Sundry small advances	2.9	—
General Average		£ 850

Overdrafts for primary producers and mercantile interests account for roughly two-thirds of the total. This demonstrates the preponderance of primary industries in bank advances.

(v) Finally it is necessary to note the establishment in 1927 of an agency of the Commonwealth Bank in New York. There is no doubt that this development is due to the increasing tendency for Australia to raise loan funds in New York. A branch of the Commonwealth Bank will facilitate these operations.

SOURCES OF BANKING AND MONETARY STATISTICS FOR AUSTRALIA

The Commonwealth Year Book issued by the Bureau of Census and Statistics, Melbourne, gives details upon deposits and assets of all Australian banks, savings banks, trustee companies, building and investment societies, coöperative societies and life assurance companies (Section E, Private Finance, of Chapter VIII of *Year Book*, No. 20, 1927). For most purposes this statistical information is adequate. The *Year Book* also gives details of State advances to settlers by the State governments. Current statistics upon banking, and the note issue is found in the *Quarterly Abstract of Statistics* published by the Bureau of Census and Statistics. Statistical records over a period of years are given in the *Finance Bulletin* published annually by the Bureau. The Commonwealth Bank publishes a weekly return giving details of assets and liabilities in the issue and banking departments. The half-yearly balance sheet contains a complete statement for all departments.

The best source of information upon current banking statistics is *The Banking and Insurance Record* published monthly (McCarron Bird & Co., Melbourne). This contains an analysis of the quarterly figures and the half-yearly balance sheets of all banks together with annual reports of leading finance companies.

CHAPTER III

THE BANKING SYSTEM OF AUSTRIA

BY

MAX SOKAL [1]

AND

OTTO ROSENBERG [2]

HISTORICAL SURVEY

At the outbreak of the World War Austria was in the last phase of a currency reform, initiated in 1892, which had progressed so far that the resumption of specie payments appeared to be a question of a relatively short time. The great catastrophe interrupted the work, as it was then thought, while it was later found that it had destroyed altogether the foundation upon which the currency, and with it the credit system of the country, was to be securely built.

During the larger part of the last century currency conditions in Austria were unsettled. The country was involved in a very large number of wars and warlike operations. The Napoleonic period was followed by military interventions in a number of Italian States and by the repression of revolts in the Austrian provinces. These operations were succeeded by other campaigns (a war with France and Sardinia, an expedition against Denmark and a war with Prussia and Italy) and their combined effect on Austria was an utter disorder of the State household and great financial exhaustion.

CURRENCY CONDITIONS IN THE 19TH CENTURY. A central bank of issue, the Oesterreichische Nationalbank, had been established at the beginning of the 19th century (1816), which was authorized to issue notes which were legal tender in all dominions

[1] Wiener Giro & Cassenverein.

[2] Foreign Department, Austrian Bankers Union.

of the Austrian Crown, with the exception of the Italian provinces (Lombardy and Venetia). A small circulation of gold and silver coins was also created subsequent to the establishment of the bank, but the drop of the exchange value of the notes caused the coins soon to disappear and after the year 1848 (revolutions in Austria and Hungary) the circulation was made up exclusively of paper. Even in the comparatively backward state of the economic life of Austria the situation was felt to be intolerable and on September 19, 1857, the Government issued a decree, establishing a new currency, the " österreichische Währung," on the silver standard. The notes of the Oesterreichische Nationalbank, however, remained legal tender and only a year later, September 6, 1858, was specie payment commenced, to be discontinued again in April, 1859. The silver gulden coined under the Decree of 1857 (45 gulden out of 500 grammes silver) again dropped out of the circulation, their place being taken by bank notes, to which were added in 1866 (war with Prussia and Italy) State notes, whose issue was not to exceed, as a rule, 312 million gulden with a possible maximum of 400 gulden.

The international valuation of this paper currency depended exclusively on the law of demand and supply and was therefore entirely unconnected with the price of silver, though silver was the nominal basis of the Austrian currency. As a matter of fact, the Austrian rate of exchange on foreign places rose above the metallic value of the monetary unit (nominally the silver gulden) and in February, 1879, the quantity of silver required for the coinage of 100 silver gulden could be purchased in London at a price which, converted into Austrian money at the then rate of exchange, amounted to 93.66 paper gulden only. This curious phenomenon was due to the drop of the silver price owing to the progressive demonetization and the increasing production of that metal. The minting of silver gulden for private accounts, which had increased considerably, was stopped in 1879, but the Government continued coining them up to 1892. Though it would have been easy for Austria under these conditions to reëstablish its (nominal) silver currency, such a course would have been injudicious at a time when the important commercial nations of Europe had all gone over to the gold standard. The adoption of the franc currency was under consideration for a certain time and

gold coins of 8 and 4 gulden (equivalent to 20 and 10 francs) respectively, were struck in the anticipation of such a reform which, in view of the unfavorable financial conditions of the country, could not be carried out, however.

THE CURRENCY REFORM LAWS OF 1892. Owing to constitutional changes which took place in 1867 and which gave Hungary a status within the Monarchy co-equal with the one of Austria, the Oesterreichische Nationalbank was reorganized in 1878 as the Oesterreichisch-Ungarische Bank. The two sovereign States (Austria and Hungary), which formed the Austro-Hungarian Monarchy, agreed in 1887 to adopt the gold standard for their common currency and the respective legislation was enacted in 1892. A new unit, the krone, equal to one-half paper gulden, was chosen and the number of kronen (in pieces of 20 and 10 kronen) to be coined out of one kilogramme of gold was fixed at 3,280.

This meant pegging the krone (one half-gulden) at the average rate at which the gulden, as expressed in francs, had been quoted in the years 1871–1891, viz. 2.10 francs. Subsidiary coins were also struck (silver pieces of 1, 2 and 5 kronen, nickel pieces of 20 and 10 hellers and bronze pieces of 1 and 2 hellers) and the silver gulden, whose coinage had been discontinued, remained legal tender, together with the notes of the Oesterreichisch-Ungarische Bank. The State notes (312 million gulden) were withdrawn from circulation, being replaced to the extent of 72 million by silver kronen and to the extent of 240 million by silver gulden or notes of the Oesterreichisch-Ungarische Bank. Against the latter issue the Governments of Austria and Hungary deposited with the Bank the amount of 480 million kronen (equivalent to 240 million gulden) in Austrian gold coins. An actual circulation of gold was also tentatively begun, but did not apparently commend itself to the public and the coins returned to the Bank. The population had too long lost the habit of handling gold and it actually happened that uninformed members of the community, when receiving payment in gold, refused it, demanding "real" money, i.e. bank notes, instead.

STABILITY OF KRONE. The Bank Law, which was amended in 1899 and again in 1911, provided that at least 40 per cent of the note circulation should be covered by the Metal Reserve, in which might be included, however, the Bank's holdings of foreign bills

in terms of a gold currency, up to a maximum of 60 million kronen. If the note circulation exceeded the Metal Reserve by more than 600 million kronen, the Bank was to pay a tax of 5 per cent on the amount of notes over and above those 600 million. It was incumbent upon the Bank to maintain the Austrian rate of exchange (expressed in terms of a gold currency) stable, but provided this were the case, there was no obligation concerning the resumption of specie payments on a definite date. This system worked so well that the krone, in its relation to foreign currencies based on gold, was perfectly stable.

The Bank of Issue During the War. At the outbreak of the war the note circulation amounted to about 2,130 million kronen and the Metal Reserve was 1,589 million kronen (1,298 million gold and foreign bills on a gold basis, and 291 million in silver gulden and subsidiary coins). The ratio of the Metal Reserve to the amount of the note circulation would have been quite sufficient, in fact, most satisfactory, in respect of all normal contingencies, but was bound to prove inadequate in the case of a universal conflagration. From the point of view of preparation for warlike purposes the financial equipment constituted by the Metal Reserve of the Oesterreichisch-Ungarische Bank was therefore quite inadequate.

War Finance Inflation. At the beginning of the war the clause of the Bank Law requiring a Metal cover of at least 40 per cent to be maintained against the note circulation as well as the obligation of the Oesterreichisch-Ungarische Bank to keep the Austrian rate of exchange stable, were tacitly suspended. The mobilization of a large army and the expenditure connected with the replenishment of military stocks of all descriptions required a huge outlay which was to be faced at once and which continued on an increasing scale as the war went on. Throughout the war, the expenditure which it entailed was raised almost completely in the form of borrowings from the Bank on various securities (Government Bonds, Treasury Bills and Treasury Certificates) as well as through War Loans. The government was unable to raise any considerable portion of the required means by taxation, as the impossibility of obtaining large supplies from abroad owing to the blockade of the Allied nations gave to Austrian production a monopolistic position, which would have enabled it to charge

taxes back to the government which was the largest consumer. Inflation at a progressively rapid rate was the necessary corollary of this peculiar state of things. The following table shows the amount of the note circulation and the current account liabilities of the Bank, together with the amount of government indebtedness at the beginning and at the end of hostilities, as well as on certain intermediate dates (January 1 and July 1 of each year. Under government liabilities to the Bank the amounts are understood which both the Austrian and the Hungarian governments obtained from the Oesterreichisch-Ungarische Bank during the period under review.

(In million kronen)

Date		Note Circulation and Ct. Acct. Liab.	Government Indebtedness	Metal Reserve	Discounts	Loans on Securities
1914	July 31	3,429	.....	1,419	1,636	410
	Dec. 31	6,563	3,915	1,194	2,053	3,394
1915	June 30	7,138	5,524	857	3,139	3,234
	Dec. 31	7,435	6,149	810	2,976	3,293
1916	June 30	9,663	9,100	591	2,884	3,219
	Dec. 31	11,313	10,907	354	2,856	3,428
1917	June 30	13,125	12,771	373	2,842	3,397
	Dec. 31	20,398	19,305	381	2,822	3,429
1918	June 30	25,436	25,422	383	2,815	3,512
	Oct. 31	34,845	35,731	342	2,812	4,734

NOTES BASED ON GOVERNMENT BORROWINGS. The above table shows clearly that the proportion of the note circulation and the current account liabilities based on private commercial and financial transactions, as contrasted with government borrowings, decreased steadily. While, at the beginning of the period, the " virtual " circulation, as it is called in Austria (notes plus current account liabilities), exceeded the amount of government indebtedness by 3,475 million kronen, the total of State borrowings reached the amount of the virtual circulation at the beginning of July, 1918 and since that time, up to the cessation of hostilities, it grew constantly larger. The table shows that, with the exception of the first two months of the war, government borrowings were almost the only source of the note issue. This happened in a

period when, in consequence of the large consumption and diminished production due to the mobilization and the military operations, the amount of goods purchasable by the colossally increased quantity of money was not augmented but greatly decreased.

External Depreciation of Currency. The effect of this state of things on foreign rates of exchange was, of course, a gradual and rapid rise of the latter. This rise, however, was not uniform and the Swiss, Dutch, Swedish and Danish exchanges moved differently against the krone at different periods. The divergence was due to the fact that arbitrage operations were impossible, that gold had lost to a large extent its function as a means for settling balances in international exchanges, some of the neutral countries having declined to receive it in payment, and that, as a consequence, the rates of exchange between Austria and these countries depended uniquely on the demand and supply of the respective instruments of payment (foreign bills, notes, etc.). Credit arrangements in existence and the view taken of the military position at a given moment, naturally played a very large part also. The following table indicates the rates of exchange of a number of neutral countries at the beginning and at the end of the war, as well as at certain intermediate periods.

MONTHLY AVERAGE QUOTATIONS

(In kronen)

	Zurich	Amsterdam	Stockholm
Parity	95.23	198.37	132.26
July 1914	95.99	199.46	......
Dec. 1914	110.10	233.77	145.60
June 1915	124.33	264.62	174.56
Dec. 1915	142.28	324.76	205.19
June 1916	148.29	323.46	230.93
Dec. 1916	180.66	369.48	265.65
June 1917	206.34	428.10	311.34
Dec. 1917	215.55	405.30	334.20
June 1918	195.78	392.61	268.95
Oct. 1918	240.04	500.20	344.05

The "Devisen-Zentrale." In this connection an institution requires to be mentioned which was created in February, 1916 and was destined to play an important rôle not only during the war,

but for a number of years after the cessation of hostilities. As in other countries the necessity to get a clearer insight into the demand and supply of foreign instruments of payment and to obtain control, as far as possible, of the exchange market, made itself felt in Austria also. In the abnormal state of the market it was felt that the State, or the central bank of issue, should pool all the supply and demand of foreign instruments of payment with a view to stabilizing, as far as possible, the rates of exchange. Germany called into being a "Devisen-Zentrale" (Central Board for the Traffic in Foreign Exchanges) and Austria-Hungary followed suit in February, 1916, though on somewhat different lines.

Under the leadership of the Oesterreichisch-Ungarische Bank the large banks in Vienna and Budapest formed an organization, adherence to which was open to other banking firms as a poll of the participants, and which was alone authorized to deal in foreign exchange. Later on membership was made subject to a government license. The agreement on which the organization was based provided that the members place at the disposal of the Central Board all their available foreign instruments of payment and apply to the Central Board for such amounts in such foreign exchanges as they or their clients might require. It was also provided that applicants for foreign exchange should indicate the use to which the foreign instruments of payment demanded by them would be put. In the case these uses were not essential for the country, the application was to be refused. The balance of this market (whether active or passive) was ascertained, and foreign exchange rates were established, daily. It was prohibited to send abroad Austrian means of payment (bank notes, checks and bills of exchange in terms of the krone), except under a special permit of the Central Board and, on the other hand, exporters of Austrian goods were required to deliver to a member of the Central Board against Austrian kronen the remittances in foreign currencies they received from abroad in settlement of their invoices.

Failure of Exchange Control. This arrangement, as was to be expected, worked only moderately well, as it left too many loopholes for transgressions in view of the manifest impossibility to enforce strictly all its provisions. It did at certain periods tend to stabilize exchange rates, especially when the Oesterreichisch-

Ungarische Bank placed at the disposal of the Board foreign instruments of payment out of its own holdings, but, as a rule, the demand for foreign exchanges largely exceeded the supply. An illicit market (Schleichhandel) soon sprang up, where quotations were far higher but more in accordance with the real situation.

These were the currency conditions at the end of the war. It will be necessary, at a later moment to resume the thread of the description where we leave it now, but, in the meantime, it is best to outline the general characteristics of the Austrian banking organization and of the credit system of the country as they have grown out of the situation which existed in Austria in the fifties of the last century and of the development which took place in the second half of that period.

The Early History of the Commercial Banks. The Austrian banking system, compared with the one of the Western European countries, is of recent growth. Up to the middle of the 19th century, Austria, which was then, in point of view of territorial extension, the second largest State in Europe, ranking immediately after Russia, was still a relatively backward state, which is accounted for by the fact that the nations inhabiting that large empire had not all reached a degree of economic development, such as was found in the west of Europe. Some of the then Austrian territories (Eastern Galicia, the Bukovina, large sections of Transylvania and of Dalmatia) were hardly developed, at least, not in the sense in which the term would be used in relation to an English county, an average French department or a Belgian or Dutch province. Production was almost exclusively for the inland market, and very restricted at that, in view of the fact that the requirements of the extensive Eastern and Southern territories of the empire were exiguous and could be met by relatively primitive methods. At the middle of the last century, a quickening in the pace of economic development made itself felt. Agrarian reforms were initiated through the Revolution of 1848, which led to the creation of a considerable number of medium and small agricultural holdings with independent capital requirements. About the same time the chief railway lines on the territory of the late empire were constructed and with the improvement of communications production received a stimulus

which made the need of a banking and credit system increasingly felt.

Development of Credit Institutions. Up to that time, there had been no banks in Austria, with the exception of the Oesterreichische Nationalbank (the bank of issue) and of a number of mortgage institutions. The first Austrian private joint-stock bank which came into existence was the Austrian Discount Company (Niederösterreichische Escomptegesellschaft), formed in 1853. It was followed soon after by the Oesterreichische Credit-Anstalt which started business on February 1, 1856. The first Austrian joint-stock banks had not, at the beginning, the large scope which has become characteristic of them in the course of the later development. The primary function of commercial banks in Austria, as of commercial banks in other countries, was to act as intermediaries between the demand and supply of capital, and the trade in securities. There had been a Bourse in Vienna since 1771 and trading in securities was not unknown in Austria, as the Oesterreichische Nationalbank was organized as a joint-stock company and there were various Government loans in existence too, but the number of securities and the amount of transactions in them had been very small. After joint-stock banks came into being, dealings in stocks and securities naturally gained largely in extent.

The business of banks was limited in the beginning to the discounting of bills, the granting of loans on securities and the opening of credits in the form of current accounts. Government loan transactions were also engaged in, but in proportion as capital seeking investment accumulated at the banks and as the number of banks multiplied, they had to look out for larger avenues of remunerative employment, which they found in the financing of industry.

The formation of the Niederösterreichische Escomptegesellschaft (1853) and of the Oesterreichische Credit-Anstalt (1855) was followed by the foundation of the Anglo-Oesterreichische Bank and of the Oesterreichische Boden-Credit-Anstalt in 1863, by the Allgemeine Verkehrsbank and the Steiermärkische Escomptebank in 1864, by the Wiener Bankverein and the Bank für Oberösterreich und Salzburg in 1869, by the Unionbank in 1870, the Allgemeine Depositen-Bank and the Oesterreichische

Zentral-Boden-Creditbank in 1871 and the Wiener Lombard & Escomptebank in 1873. All of these banks, with the exception of the Steiermärkische Escomptebank (Graz) and the Bank für Oberösterreich und Salzburg (Linz) had their headquarters in Vienna. In 1872 the Wiener Giro- und Cassen-Verein was established, whose rôle as a central stock-clearing institution will be referred to in a later section of this chapter. The formation of these companies and their development up to 1873 forms the first phase in the history of Austrian banking. It was contemporaneous with an enormous extension of stock exchange speculation consequent upon the large number of company promotions which set in soon after the war (with Prussia and Italy) of 1866. This was a time of unrestrained gambling in many countries, which led in Austria to the precipitate foundation of enterprises, some on a fraudulent basis, aiming in many cases only at the profit obtainable through the issue of shares. The hypertrophic growth of stock exchange transactions relegated to the background the regular banking business.

Crisis of 1873. The Stock Exchange crash of 1873, however, brought this period to an end. Seen from a distance, this catastrophe, in the same manner as the slump of 1924, to which reference will be made in the course of these pages, was a blessing in disguise, in so far as it did away completely with the rank growth of unsound foundations, thereby clearing the ground for a healthy development of the remaining solid enterprises along lines of commercial respectability. One of the consequences of the crisis of 1873 was that the number of Austrian joint-stock companies which, at that time, was 875 with a paid-in capital of 1261 million gulden, was reduced in 1879 to 411 joint-stock companies with a paid-in capital of 603 million gulden. The number of banks and banking firms dropped from 141 in 1873 to 45 in 1878. Another consequence was that the public, whose relatively fresh experience of the share market had proved so unfortunate, conceived a dread of the Bourse and a disinclination, which was slow to wear off, to engage in stock exchange operations. As the public ceased to count as a buyer, existing enterprises requiring fresh funds had to rely to a larger extent on the banks. The banks were also obliged, during the depression which followed the crisis of 1873, to support the market by buying the shares of

the sounder undertakings and both facts in conjunction led to the peculiarly close connection which exists in Austria between the financial institutions and the other branches of economic life.

Nature of Banking Before the War. In the meantime (i.e. after 1873) a process of concentration or rather a movement towards closer coöperation, had been going on in the Austrian banking organization, which found expression in communities of interest relating to several branches of economic life, in the joint formation by several banks of affiliated banking institutions, in the joint participation in industrial and financial enterprises, etc. The common activity of the banks and the requirements of the times also led to a far-reaching assimilation of the kind of business engaged in by the various banking companies. While, in the first period of their activity, some banks had specialized on a particular kind of business, these distinguishing features were gradually merged into a common type of commercial bank. While some banks continued to pay special attention to the business to which they had been devoting themselves exclusively at the beginning (e.g. mortgage or big syndicate business) they were all driven in a more or less like manner, in consequence of the conditions created by the stock exchange crash of 1873, to support and finance private industrial undertakings. When, owing to the very pronounced progress made by the German industry in the nineties of the last century, conditions appeared favorable for an extension of the Austrian industrial equipment as well, the Austrian banks rendered conspicuous service in this connection to the national economy of the late monarchy.

Industrial Banking. They not only formed underwriting syndicates for the issue of industrial shares, but they also retained, or were obliged in many cases to retain, some part of the stocks so issued in view of the still restricted market which existed for values of that kind. The intention was to hold these stocks temporarily pending an improvement of market conditions, but as a matter of fact, it has remained a permanent and characteristic feature of the Austrian banks to own a controlling, or at least an important, interest in many industrial and commercial enterprises. This entailed many-sided activities and responsibilities. On the one hand, the bank (or in some cases two or more banks jointly) acted as underwriters of the issue and at

the same time as creditors to the enterprise advancing to it funds on current account or on some sort of security, and, on the other hand, they were, simultaneously, shareholders, and frequently substantial shareholders, of the new companies. As those companies naturally transacted all their banking business through the bank or banks with whose support they had been established and which in all cases owned a considerable interest in the respective industrial or commercial undertakings, the close connection between financial and industrial (or commercial) capital which has remained typical for Austrian national economy was still more firmly cemented. It should be borne in mind that this connection between the Vienna banks on the one hand and production and distribution on the other hand existed not only in relation to enterprises situated on the present territory of the Austrian Republic, but in view of the large extension of the pre-war Austro-Hungarian Monarchy nearly all the industry of what are now known as the Successor States was drawn into the orbit of, and made in some way dependent upon, the Vienna banks.

Later Growth of Joint Stock Banks. In the period beginning with the stock exchange crisis of 1873 and ending about the year 1900 only two joint-stock banks of importance were established, namely the Oesterreichische Länderbank (now the Banque des Pays de l'Europe Centrale, with headquarters at Paris) in 1880, and the Bank und Wechselstuben A. G. Mercur (at present styled the Mercurbank A. G.) in 1887, to which was added in 1896 the Oesterreichische Credit-Institut für öffentliche Arbeiten with a specially defined sphere of activity, namely the financing of Railroads, of Public Utility Corporations and similar enterprises. While, in spite of the rally in economic life, the growth of the number of joint-stock banks in the country was small during that period, the larger turnover of the existing banks necessitated increases of the capital of the banks. The share capital of all Austrian joint-stock banks, which was 615 million kronen in 1895, reached 777 million gold kronen by the year 1900. Towards that time over-production in Germany led to a crisis there, which made its effects felt in Austria too, but did not interrupt for long the favorable economic development of the country. While in the following eight years only two banks were established, namely the Centralbank der deutschen Sparkassen at Prague in 1901 and the

Bank für Tirol und Vorarlberg at Innsbruck in 1904, new banks were established in rapid succession from 1909 up to the year 1923, but the majority of these foundations did not last over the crisis of the year 1924, which marked a further turning point in the history of Austrian banking. Before dealing with this latest phase, however, it is necessary to review briefly the history of Austrian banks during the war and in the years immediately following the conclusion of peace.

War and Postwar Problems of the Banks. The outbreak of the war for a time completely paralyzed the activity of the Austrian banks. The suspension of Bourse meetings as well as a moratorium declared at the beginning of hostilities and remaining in force with various modifications subsequently enacted for about one year, made the transaction of normal business almost impossible, at any rate in the initial period of the war. A new field of activity was opened to the banks, however, through the financial requirements of the government and the successive issue of eight Austrian war loans of a nominal total of 35,129,-324,600 kronen and net proceeds amounting to 32,955,576,990 kronen. Hungary issued her own war loans (17), whose nominal total amounted to 18,851,835,850 kronen, with net proceeds of 17,955,885,538 kronen. In the case of the war loans the banks, as a rule, advanced to the government the estimated proceeds of the issue before the subscription was closed. They were able to do so in view of the fact that the nominal amount of deposits held by them had grown very much, the average depositor earning a considerably larger nominal income, while the means of spending and the choice of investments were restricted during the war.

Self-Determination in Banking. A number of exceptionally big problems confronted the banks at the end of the war. The former Austrian provinces, on obtaining their political independence, were naturally desirous to sever the connection which had hitherto existed between the large Vienna banks and enterprises situated within the territory of these new states, in order to eliminate the influence of Austrian banking capital over their national economy. This process known as the " Nostrification " was successful to a certain extent only and in varying degrees, depending upon the plane of economic development reached

by the respective country. There was a danger then of the Austrian banks losing completely the ground which they held in those countries. In the course of time, however, the spirit displayed towards Austria improved and it became possible, through amicable arrangements, to save part of what might be called the foreign "good-will" of the Austrian banks, though under a modified form.

Legal Handicaps Affecting the Banks. Other extremely difficult tasks were set to the banks by the internal conditions of Austria. An enormous load of unproductive work was heaped on the banks through a complicated system of supervision, blocking of accounts, official control of the trade in foreign bills, compulsion for clients to prove their legal and national status before becoming entitled to dispose freely of their deposits, intricate and very stringent taxation laws, in a word, by a large number of vexatious measures which were either required for carrying out certain provisions of the Peace Treaty and of subsequent agreements, or else were thought to be necessary in the interest of the Austrian currency and in view of the financial requirements of the Austrian Government. As a consequence, the banks were driven to make large additions to their staff, which increased expenditure and made business profitable only at higher bank charges. A further great difficulty was created through the fact that, in the very far advanced state of depreciation of the krone, the banks had to discharge liabilities contracted previous to the war towards nationals of the ex-enemy states.

The Commercial Banks During the Inflation Period. The business of the banks underwent great modifications during and after the war. Stock exchange transactions were entirely paralyzed at the beginning of hostilities through the closing of the Bourse, and the foreign exchange business was nearly stopped through the enemy blockade. At that time, the banks were almost exclusively occupied with the financial assistance given to the government. When the Bourse was reopened, the public was attracted to stock exchange operations by the rise of quotations which accompanied the drop in the purchasing power of the krone. This process, which began in 1917, continued as the depreciation of the currency went on at a progressively rapid rate until September, 1922. A great number of capital issues which

had to be effected, in view of the decline of the krone, in order to bring fresh funds to banks and industrial enterprises, gave added zest to the speculation and swelled the amount of stock exchange operations with which the banks were intrusted by their clients. The condition of the banks seemed very flourishing at that time and while the war period had already produced a great increase in the number of banks and banking firms, the growth which took place in the period immediately following the war, was mushroomlike. All the *newly* established banks and banking firms engaged almost exclusively in stock exchange gambling and, when the moment appeared propitious, in speculations in foreign exchanges. Bull transactions in stocks were then thought by nearly all the " new-fangled " bankers and by the overwhelming majority of the public, to be by far the easiest way of acquiring wealth.

As a matter of fact, as long as the krone pursued its downward path, the prices of stocks (as well as the prices of other commodities) were bound to rise, irrespective of the earning capacity of the enterprise by which they had been issued. The fact that, expressed in terms of a stable currency, the inflated kronen figures did not contain a profit but meant a loss of value, did not enter into the heads of the masses. Besides, they had turned to the stock exchange with the purpose of maintaining unimpaired as far as possible their savings and surplus funds, which, through the continuous decline of the Austrian currency, were threatened with annihilation, and all other roads leading to the desired goal were beset with so many difficulties that they were open to the few select only.

Speculation in Foreign Exchange. Business in foreign bills also increased after the cessation of hostilities, not only in view of the raising of the blockade, but in a higher degree owing to the fact that at least six new national currencies (in addition to the currency of the Austrian Republic) sprang into existence in what had been one economic unit (the Austro-Hungarian Monarchy) with one currency up to the end of the war. Inducement was offered to speculation in foreign exchanges by the circumstance that one Central European currency after another began to topple down with no apparent prospects of a definite rally. It appeared safe therefore to buy on a credit obtained in the respective currency, real estate, stocks and commodities, as at the moment when

the deferred payment became due, the discharge of the liability was often possible at a fraction of the originally agreed value. The activity of the Central Board for the Traffic in Foreign Exchanges (Devisen-Zentrale) put some hindrance to this gambling, but loopholes could be found by transgressors in the framework of the regulations with comparative ease.

Recent Developments. The latest phase (commencing in the summer of 1922) in the history of Austrian banking is marked by three facts of outstanding importance: the stabilization of the Austrian currency with its concomitants, the crisis of 1924, and the concentration movement which has been on foot since the lessons taught by that crisis have been better understood. It would appear advisable, however, to reserve a discussion of this latest phase to the section where the present financial organization of the country is dealt with.

CREDIT INSTRUMENTS

The commercial credit instruments in use in Austria (bills of exchange and, in a restricted sense, checks) offer no peculiarity and the legal requirements which they have to fulfill, as well as the provisions enacted in regard to the liability of drawers, drawees and endorsers are similar in their essential points to those in force in other civilized countries, having especially been planned on the German model, so that they need not be detailed here.[3] Conditions are somewhat different, however, in regard to investment credit instruments, as some types in use in the United States and elsewhere are unknown here and vice versa. A brief account of the usual forms existing in Austria will therefore be given here.

Investment Credit Instruments. In regard to investment credit instruments Austria has not evolved any special type but

[3] Efforts continue to be made under the auspices of the International Chamber of Commerce at Paris to arrive at a closer approximation and, if possible, at a complete assimilation of the enactments in force in the various countries. The Austrian Committee of the International Chamber of Commerce has also submitted suggestions and draft regulations for consideration, but the subject presents very great difficulties and no agreement is at present in sight.

those usual in countries whose economic development on modern lines commenced earlier, have been adopted by custom and legislation with slight variations. Some forms, however, have never been widely used in Austria and the tendency seems to be towards a greater unification of types and the gradual elimination of some varieties of investment credit instruments. In the following discussion investment credit instruments will be classified in two groups, viz. shares and bonds, with further subdivisions of the latter.

Shares. The large majority of Austrian shares are common (holder) stocks transferable without any formality. Comparatively few companies (some railway, navigation and insurance companies) have issued shares inscribed in the name of the owner and one bank (the Niederösterreichische Escomptegesellschaft) also adheres to this type. Shares inscribed in the name of the owner are transferable with a simple endorsement. No efforts are made to verify the signature of the endorser and, where it is omitted by negligence, it is frequently simply added by somebody else. The requirement to have such shares endorsed is therefore more in the nature of a pure formality and most of the companies, which originally issued such shares, have gone over on the occasion of later capital issues to the other type, namely holder shares.

Preferred Stock. Very few Austrian companies have issued preference shares (Prioritätsaktien). Preference shares rank before the common stock in regard to dividends and to the quota of net proceeds in the case of the liquidation of a company. They do not, however, confer a right to a definite amount of dividend, if the net profit of any one year is insufficient for the purpose. The institution of cumulative preference shares, as they are in use in Great Britain and in the United States, is unknown in Austria. No Austrian bank has issued preference shares, and the variety in question appears to be gradually vanishing.

Nominal Value of Stock. The nominal value of Austrian shares varies immensely. Under the Gold Balance Act of 1925, the minimum nominal value of the shares of a company is fixed at S 10.—. Companies whose shares, owing to the depreciation of the Austrian currency during the inflation period, have dropped below that value, must reduce the number of shares by exchanging two or more old shares against one new share of at least the

required minimum face value (Zusammenlegung von Aktien). This exchange has not yet taken place in respect of all companies, and, as a matter of fact, the shares at present on the Vienna Stock Exchange list represent all amounts of nominal values. The position will be simplified when the exchange of old shares against new ones will have been effected by all Austrian companies, but even then the diversity of nominal values will be considerable.

The prices of shares on the stock exchange list are in schillings per share. The Trading Unit (Schluss) consists, as a rule, of 25 shares, but trading units of one, five, ten and fifty shares also occur. Generally speaking, the highly priced securities have smaller trading units. The number of shares constituting a trading unit is indicated in the stock exchange list for every individual stock.

Bonds. The Austrian bonds quoted on the Vienna Stock Exchange are divided into several categories (Government Bonds, Railroad Debenture and Mortgage Bonds, Mortgage Bonds of Hypothecary Credit Institutions and Lottery Loan Bonds). The Government Bonds themselves can be classified under a number of heads, viz. Loan Stock of the Austrian Republic, Pre-war Austrian Government Bonds, Pre-war State Railroad Mortgage Bonds, etc. The loan stock of the Austrian Republic, as well as pre-war Government Bonds, run in terms of various currencies. The quotations on the stock exchange list in the former case (loans of the Austrian Republic) are in a percentage of the nominal value in the respective currency. In the case of pre-war government bonds [4] the quotation is in schillings for one hundred units of the respective currency, except in the case of bonds in terms of the Austrian gulden (the Austrian currency unit before 1892), when the list price is for 50 units. Pre-war State Railroad Mortgage Bonds, Private Railroad Debenture and Mortgage Bonds, as well as Mortgage Bonds issued by Hypothecary Credit Institutions, are quoted in schillings per 100 units of the respective currency. The quotations of Lottery Loan Bonds, however, are not in percentages but for the nominal value of each bond.

[4] As no valorization has taken place in Austria, the government pre-war and war loan stock has been totally depreciated and is now of no importance whatever in the stock exchange business. It has been included, however, in the above survey for the sake of a complete explanation of the listing method on the Vienna bourse.

As bonds are generally issued in various denominations, trading units are not, as a rule, defined as so many bonds but as bonds of a certain aggregate nominal value (e.g. \$50.—, £10.—, Frs. 1,000, 10,000 marks, 5,000 old Austrian gulden, 1,000 schillings, etc.). Lottery Loan Bonds, however, have their trading unit invariably fixed as so many bonds. The stock exchange list indicates the amount or the number of bonds constituting a trading unit. All bonds are to holder and transferable without formality.

FINANCIAL ORGANIZATION IN AUSTRIA

The main types of Austrian financial institutions are:

(a) Commercial Banks
(b) Savings Banks
(c) Provincial Mortgage Institutions
(d) Credit Associations for Tradespeople
(e) Agricultural Credit Associations.

In addition to these forms of organization there are three corporations whose functions in the monetary and credit system of the country are of a special nature, namely:

(1) the Austrian National Bank (the sole bank of issue of the country)
(2) the Austrian Post Office Savings Bank and
(3) the Wiener Giro- und Cassen-Verein.

The rôle of the various types of financial institutions, as well as of the three special organizations, requires to be discussed in detail, but as the central bank of issue and the functions with which it is invested are the main pillars of the Austrian credit system, it is fit to review the position under these aspects first.

The Austrian National Bank. At the time when the Austro-Hungarian Monarchy broke down (in November, 1918) the Austrian krone was the common currency of all the countries which obtained national independence through the disruption of the old State. As it was then already certain that the note circulation of the Austro-Hungarian Bank would be partitioned among all the countries which had formed part (or territories of which had formed part) of the former Monarchy, it was evident that steps

would be taken in each individual country to ascertain the amount of notes of the Austro-Hungarian Bank circulating in the respective state at the cessation of hostilities. A beginning was made in this respect by Yugoslavia (on January 8, 1919) which ordered all notes of the Oesterreichisch-Ungarische Bank to be stamped with a distinctive mark. The other countries followed suit, and the Austrian Republic could not remain behind, as there would otherwise have been a danger of notes, not stamped in the other Succession States, flowing back into the Austrian Republic and increasing the quota for which the country was to be responsible. This process marked the end of the old currency and the coming into existence of national currencies.

Liquidation of Austrian-Hungarian Bank. The Peace Treaty of St. Germain provided for the winding-up of the Oesterreichisch-Ungarische Bank. As the Austrian Republic in its then state of extreme exhaustion was not capable of creating a new bank of issue, the liquidators of the Oesterreichisch-Ungarische Bank sanctioned the further use of the organization for the purposes of the Austrian Republic under the style of " Oesterreichische Geschäftsführung der Oesterreichisch-Ungarischen Bank " (Austrian Management of the Austro-Hungarian Bank). It requires to be stated, however, that this Austrian section was legally entirely independent from the Oesterreichisch-Ungarische Bank, which, while in course of liquidation, was still the common property of all Successor States. The " Oesterreichische Geschäftsführung " (Austrian Management) was a purely Austrian institution, whose business and note issue concerned Austria alone.

Continuation of Government Inflation. With the productive and distributive organization of the country entirely exhausted through the long war and with immense financial requirements for feeding and clothing a population which had literally exhausted all available stocks, the Government of the Austrian Republic was, of course, compelled from the beginning to have recourse to the printing press for obtaining the necessary funds to pay its way. Government Certificates of Indebtedness were delivered to the Austrian Management of the Oesterreichisch-Ungarische Bank, and the bank in turn supplied notes for a like amount. This process was repeated up to the stabilization of the

currency, whenever the government needed funds. The Austrian krone, in consequence of this inflation, not only continued to decline, but its fall soon became so precipitate that, from one day to another, losses of 20 and even 30 per cent sometimes occurred.

FINANCIAL AID TO AUSTRIA. During all the time foreign aid for stabilizing the currency had been hoped for, as it was obviously beyond the means of the country to achieve that stabilization through its own efforts. When the krone had dropped to one four-thousandth part of its nominal parity of exchange, the government then in office came forward with a plan for the financial reconstruction of the country, involving, amongst other measures, the creation of a new bank of issue, which was to be entirely independent of the State, as the first step in a currency reform. The respective bill which provided for the establishment of an Austrian National Bank with a capital of 100 million gold francs to be subscribed in the country, obtained force of law on July 24, 1922, but was never carried into effect, as, in the meantime, the League of Nations had taken up the question of international financial aid to Austria. At the September meeting of the League's Council a favorable decision was given and under the Geneva Protocols, signed on October 4, 1922, the Austrian National Bank was formed as a joint-stock company with a capital of 30 million gold kronen, the major portion of which was subscribed in the country.[5]

GENERAL ORGANIZATION. At the head of the Bank is the General Council, consisting of the President, appointed by the government for a period of five years, and thirteen members elected for a like period by the General Meeting of Shareholders. The members of the General Council choose from their midst two Vice-Presidents whose election is subject to a confirmation by the Austrian Government. The President in General Council directs the policy of the Bank (discount policy, methods used to control credit, control over foreign exchanges, etc.) and under him a Board of Management (Direktorium) with a General Manager (General-Direktor) at its head, is responsible for the transaction of current business. The members of the Board of Management

[5] In the meantime the value of the krone had dropped to one fourteen-thousand four-hundredth part of the gold parity. At that rate it was eventually stabilized.

are appointed by the General Council. With the exception of the President and the Vice-Presidents, the members of the Council act in a purely honorary capacity.

Composition of General Council. The President in General Council is the most important organ of the National Bank, directing and supervising the general administration of the Bank's property, laying down the guiding rules for the transaction of business, determining the amount of funds to be allocated to each branch of the business and fixing the official bank rate as well as the rate of interest for loans on securities. Foreigners (representing foreign shareholders) are eligible for membership to the Council, but their number must not exceed four. Austrian nationals who are on the Board of a foreign enterprise are deemed to be on the same footing as foreigners in this respect. The following branches of the economic life must be represented on the Council Board by one delegate each:

(1) Institutions engaging in the banking business
(2) Savings Banks
(3) Industry
(4) Commerce and Trade
(5) Agriculture
(6) Labor

The central organization of every one of these groups submits the names of three candidates, one of whom is elected by the General Assembly of shareholders. A person elected to the General Council has to deposit with the Bank for the duration of his office fifty unencumbered shares of the National Bank. The members of the Council representing commerce, trade, agriculture and labor organizations, however, have to deposit twenty unencumbered shares only. Federal employees, members of either House of Parliament, and members of ProvincialDiets are not eligible for membership to the General Council of the Bank. It is further provided that not more than four members of the General Council may be chosen among persons who have a seat on the Board of an institution which engages in regular banking business.

Powers of General Council. The General Council, which is convoked by the President of the Bank as a rule once a month, and at whose meetings the General Manager attends in an advisory capacity, can make decisions on any of the subjects re-

served to the Council, if at least eight members (including the President, or, in his absence, one of the Vice-Presidents) are present. An absolute majority of the members present is necessary for all decisions, the President (or in his absence one of the Vice-Presidents) having a casting vote. In two cases specially mentioned in Art. 65 (5) and 85, respectively, i.e. for the designation of the stocks and securities on which the National Bank may grant loans and, if it should be intended, before specie payment is resumed, to reduce below 25 million gold kronen the amount of deposits kept abroad, the assent of at least eight members of the General Council and of the President is required. Members of the General Council and of the Board of Management are jointly and severally responsible for any damage resulting from an infraction of this provision. In the case of an urgent decision becoming necessary on any subject reserved to the General Council, an Executive Committee, consisting of the President, both Vice-Presidents, the General Manager and the Assistant General Manager may provisionally take a decision by a majority of votes, but the decision so arrived at must be referred to the General Council at its next meeting, when the Council may take a fresh vote on the subject.

The State Commissioner. The Austrian Government is represented at the Bank by a State Commissioner (Staatskommissär), whose duty it is to watch over the observance of the laws and regulations governing the business of the bank. The State Commissioner is entitled to attend all meetings of the General Assembly of shareholders, of the General Council, of the Executive Committee and of the monthly meetings of the Board of Management. He is entitled to all information which may be necessary to him for carrying out his duties and to a suspensive veto against decisions which appear to him not to be in conformity with the laws and regulations. If on a point on which the State Commissioner has recorded his dissent, no agreement is arrived at with the government, the matter is to be referred to an Arbitration Tribunal which consists of the President of the Supreme Court of Justice as chairman and four members, two of whom are appointed by the government and two by the Bank.

Foreign Financial Supervision. A foreign financial expert,

nominated by the League of Nations but formally appointed by the Federal President, acts as adviser (Berater) to the National Bank. He is entitled to attend all meetings of the General Council, of the Executive Committee and of the Board of Management and to take cognizance of all documents referring to the business of the Bank. In regard to decisions under Art. 64 (5) and 85 (see above) his consent must be obtained. The appointment of a foreign adviser is an indication of the skeptical frame of mind in which the League found itself in regard to the financial reconstruction of Austria, but it has since been increasingly realized that as a precautionary measure against any departure from the strict rules of banking, the appointment was unnecessary.

The Functions of the Bank. The object of the Bank is defined as follows in Art. 1 of its charter:

" The Austrian National Bank shall be a joint-stock company, established for the purpose of regulating the circulation of money within the territory of the Austrian Republic, of facilitating the compensation of payments and providing for the utilization of available capital within the limits of these statutes. Its main function, however, will be to prepare the introduction of cash payments (redemption of bank notes in specie) by forming a reserve of precious metal and of deposits payable in stable currencies and to ensure the continuance of cash payments once they have been introduced by law."

" The Bank shall use all the means at its disposal to ensure that until the redemption of paper money (bank notes) in specie has been regulated by law, the value of its notes, when expressed in the currency of a country having a gold standard or a stable currency, shall at least not depreciate."

Note Issue Privilege. The Bank, whose privilege extends to the end of 1942, and which began its operations on January 2, 1923, took over from its predecessor (the Austrian Management of the Oesterreichisch-Ungarische Bank) the total note circulation and the current account liabilities, as well as certain assets, especially the Metal and Foreign Bills Reserve and the discounts. Foreign bills in the possession of the Devisen-Zentrale (Central Board for the Traffic in Foreign Bills) were also transferred to the new company. The certificates of indebtedness which the successive governments of the Austrian Republic had delivered to

the Oesterreichisch-Ungarische Bank (Austrian Management) were likewise taken over by the Austrian National Bank and were treated as a gradually redeemable liability of the State (Federal Debt to the Bank) under Art. 53 of the Bank Statute. In addition to redemption according to a special schedule, the share in the net profit of the Bank, to which the Federal Treasury is entitled, has since been used for the purpose of reducing the amount of the debt and the revenue accruing to the government from the minting of subsidiary coins has also been employed in this direction. Altogether, in the course of five years and three months (i.e. until April 7, 1928) an amount of nearly 88 million schillings, equaling about 12.5 million dollars, has been repaid to the Bank by the government in this manner. Every precaution has been taken to prevent a repetition of the process which was the origin of the Federal debt to the Bank. Art. 50 of the Bank Statute lays down the injunction that " Neither the Federation nor the provinces nor the municipalities shall in any way, either directly or indirectly, have recourse for their own purposes to the resources of the bank unless they shall have paid in the equivalent of the notes received in gold or in foreign credits." . . . The Federation is bound not to issue State paper money during the term of the Bank's privilege and also to undertake no measures which may be likely to hinder the Bank in the fulfilment of its obligations under Art. 1 (2). With a view to enabling the Bank to prevent the depreciation of the currency and to pave the way towards a resumption of specie payments it is provided in Art. 85 (2) that " the total of the note issue and immediate liabilities, after deduction of the Federal Loan debt, shall be covered by the cash reserve to the extent of 20% for the first five years, 24% for the following five years and 33⅓% for the rest of the period. Foreign currency (Valuten) and foreign credits (Devisen) may be included in the cash reserve." This provision shows that the framers of the Bank Act, under the depressing experience of the inflation period, far underestimated the rate at which the financial reconstruction of the country was to progress. An example chosen at random will show this. Take, for instance, the amount of the notes in circulation (including the daily maturing liabilities of the Bank), and the figure at which the Federal debt to the Bank stood on January 7 of each successive year.

	In schillings, ('000's omitted)					
	1923	1924	1925	1926	1927	1928
Total Circulation	447,089	767,382	880,354	916,335	964,191	1,021,773
Federal Debt	255,794	253,343	217,727	187,863	177,211	173,117
Under Art. 85 (2) the latter item may be deducted from the former for the purpose of computing the ratio of the metal cover	191,295	514,039	662,627	728,472	786,980	848,656
A metal cover of 20% only during the first five years and of 24% during the following five years (beginning January, 1928) being required under Art. 85, this provision would have been complied with if the metal reserve at the above dates had amounted to	38,259	102,807	132,525	145,694	157,396	203,676
As a matter of fact, however, the metal reserve at these dates amounted to	119,519	436,769	352,143	502,485	537,447	455,273
While other foreign bills[6] not included in the metal reserve figured at			127,939	55,831	134,317	272,495
And the total cover of the circulation by gold and gold credits therefore amounted to			480,082	558,316	671,764	727,768

The manner in which the Bank was able to accumulate a metal reserve far in excess of the legal requirement will be discussed in a later paragraph of this section.

Tax on Excess Note Issue. Notes can be issued in excess of the contingent, which is limited by the amount of the gold (or gold exchange) cover, subject to a graduated tax being payable to the Federal Government when the ratio of the reserve falls below the minimum. Instead of fixing a definite maximum

[6] With the exception of the length of time for which they run, these bills are now in every respect equal to those included in the metal reserve.

amount of notes to be issued, Austria in common with Germany, the Succession States and some other countries has adopted the system of "indirect limitation." The respective provision (in Art. 88 and 89 of the Bank Statute) is as follows:

If in the period between the paying up in full of the share capital and the adoption of cash payments the amount of notes issued, together with all immediate liabilities should after deduction of the Federal Loan Debt, exceed the maximum ratio between the note-issue and the cover stipulated in Article 85, a note-tax on the excess shall be paid to the Federation.

The taxation rate shall be the current discount rate, plus the following increases:

(a) 1%, if the proportion of cover (Article 85) amounts to less than 20% (or 24, 28, or 33⅓% respectively), but to more than 18% (or 22, 25½, or 30% respectively), and

(b) a further 1½% for every further 2% or fraction of 2% by which the proportion of cover falls below 18% (or 22, 25½, or 30% respectively).

The taxation rate must, however, be at least 5%.

After the resumption of cash payments, the Bank shall pay a note-tax as soon as the proportion of cover (Article 87) falls below 40%.

The taxation rate shall be the current discount rate, plus the following increases:

(a) 1% if the proportion of cover (Article 87) is less than 40% but more than 33⅓%.

(b) a further 1½% for every further 3%, or fraction thereof, by which the proportion of cover falls below 33⅓%.

The note-tax must, however, be at the rate of at least 5%.

Nature of Operations of the Bank. The statute also precisely defines the sphere of business in which the Bank may engage and the capacity in which it may act. The Bank, on certain conditions to be detailed hereunder, is entitled:

(a) to discount and to negotiate bills, securities, dividend coupons and warrants, issued by public warehouses;

(b) to grant loans on securities;

(c) to receive into safe keeping precious metals (in bullion and coins), money, securities and documents, as well as to engage in deposit and current account business;

(d) to issue to the public on receipt of a sum of money cheques or bills of a corresponding amount, payable at the Bank's own pay offices at another place;

(e) to do business on commission for account of clients (collection of bills, purchase of securities, of precious metal, of foreign bills and exchanges, if their value has been previously paid to the Bank; sale of such securities, precious metal, foreign bills and exchanges, if they have been previously supplied to the bank);

(f) to buy and sell gold and silver in bullion and/or coins;

(g) to buy and sell in the country and abroad bills and cheques on foreign places, as well as foreign bank notes, to buy and sell bills of exchange in terms of a foreign currency but payable in the country; to maintain abroad the credit balances required for these operations and to engage in the transactions which are required to ensure a remunerative investment of the funds kept abroad.

The most important of these branches of business are those under (a), (c) and (g).

Discount Business. The bills of exchange which the Bank is authorized to discount must be in terms of the legal currency of the country and payable in the country within a period not exceeding three months. They must bear, as a rule, the signature of three, but at least of two, parties, who are known to be solvent. Under the same conditions the Bank may also discount bills drawn by a government department on a private party for customs duties or other public dues, the deferred payment of which has been authorized by the respective department, and the same conditions apply to commercial bills drawn by enterprises under State, provincial or municipal ownership, provided these enterprises are regularly entered as business concerns in the register of commerce, or are managed on a commercial basis and independently from the State, provincial or municipal administrations. At all places where the Austrian National Bank maintains an office, a committee of scrutiny, appointed for a period of three years by the General Council of the Bank under the chairmanship of a senior officer of the Bank, decides on the question whether a bill or the bills which are offered for discount are suitable. The Board of Management, however, is entitled to refuse bills even if

they are pronounced to be suitable by the committee of scrutiny. Members of the committee are, of course, precluded from voting on bills offered for discount by a firm with which they are in any manner connected. The sons, partners or managers of persons who are members of the General Council or of the committee of scrutiny cannot be appointed to that committee. The committee also decides in the same manner on warrants issued by public warehouses, but the discount of these instruments hardly occurs in Austria.

Discounts Small. Altogether, the discount business, though it is naturally of great importance owing to the influence it exerts on the rates of interest ruling at a given moment, and on the movement of capital, has, with the exception of certain periods, been always small in extent in Austria, if measured by the dimensions it reaches in other countries. During the larger part of the existence of the Bank the total amount of discounts has been under 15 per cent of the total circulation and sometimes below 10. The causes to which this phenomenon is due, are twofold. One is connected with the business habits of Austria, where the use of bills of exchange is only slowly gaining ground, and the other cause lies in the fact that since the success of the financial reconstruction of Austria has become manifest and the National Bank has proved its ability to maintain unimpaired the value of the currency, a large amount of foreign loans (mostly short-term) has been granted to Austrian private enterprises, and recourse to the discount of bills was therefore less frequently necessary.

Discount Policy of the Bank. The discount policy of the Bank during the four and a half years of its existence (it commenced operations on January 2, 1923) was at certain times differently regarded here and abroad, though it is at present universally recognized that the management has been prudent and in strict accordance with the approved principles of banking. The official rate which the Bank took over from its predecessors, was 9 per cent. It was maintained during the whole of 1923, when the weekly average amount of discounts held by the National Bank was 82,967,381 schillings and the weekly average of the note circulation plus the daily maturing liabilities amounted to 574,593,492 schillings.

Speculation on the Stock Exchange. A rate of nine per cent, however, in no way corresponded to the then state of the money market. A bullish spirit prevailed on the Stock Exchange and the rates of money for Bourse operations, which were paid without question in the expectation of a continued rise of stock prices, were excessive. As a matter of fact, large profits on the Bourse made speculators disinclined to listen to counsels of prudence. On the other hand, severe competition was in progress between certain savings institutions, notably small commercial and savings banks in the provinces, with a view to attracting savings deposits and the rates of interest on the latter were continually driven up.

With the ordinary methods of the discount policy these practices could not be combated efficaciously, and the National Bank, unwilling to contribute to an increase of the cost of credit in production, which would have been the consequence of a higher rate of discount, held out as long as possible. At the beginning of January, 1924, the amount of discounts held by the National Bank was 132,337,000 schillings (as against 77,935,519 schillings one year before). During the first two weeks of January that amount dropped, but, contrary to the experience of previous years, it then began slowly to rise. This reopened the question of a higher rate of discount. The General Council, however, abstained from a general increase, but made the discount of bills running more than thirty days and bearing the signatures of two firms only, subject to an additional charge of two per cent (February 5, 1924). The effect of this measure did not become apparent, however, as a strike of bank clerks occurred in the second half of February, during which time only the strictly indispensable business could be transacted by the banks.

Speculative Forces Combated. In anticipation of the coming strike the banks accumulated large cash reserves, which caused a sudden and considerable increase of discounts. In the meantime, conditions on the stock market had become very critical, the index of Bourse values having dropped 38 per cent from the beginning of the year to the end of April. This, in connection with extensive gambling against the French franc, which miscarried owing to the sudden appreciation of that currency, created an urgent necessity among speculators to get rid of their

stocks. With a view to preventing a further catastrophic fall of stock prices, a syndicate was organized for the purpose of supporting the market. The amount of discounts of the National Bank, which was 175.9 million in the middle of April, rose rapidly in consequence, making necessary an increase of the bank rate from 9 to 12 per cent on June 5, 1924, which brought no relief, however, as the amount of discounts reached a further high level (its maximum in fact) on August 7, with 332.8 million schillings. On August 12, 1924 the bank rate was again raised from 12 to 15 per cent.

"Devisenkostgeschäft." The increase of the amount of discounts was probably due to the withdrawal of foreign credits, this withdrawal in turn being the consequence of misgivings which made themselves felt as to the stability of the Austrian currency. With a view to countering these misgivings the National Bank introduced a new form of foreign exchange transaction. Through this form which is known as the "Devisenkostgeschäft," the public was enabled to sell to the Bank foreign bills and to repurchase them after an agreed period at the same rate of exchange. The exchange risk was therefore eliminated for clients of the Bank engaging in this transaction in consideration whereof they had to consent to a small charge (Kostgeld).[7] This induced foreign credits, which had stopped during the crisis, to flow into the country again and as they were used partly in place of the short-term credits otherwise obtained through the discount of bills, the amount of discounts held by the National Bank decreased again. It was 202.2 million schillings in the first week of November, 1924, and the National Bank felt warranted therefore in decreasing its rate of discount to 13 per cent on October 5.

Decline in Discounts. Though discounts dropped further and though the public was urgently demanding a reduction of the bank rate, the latter was maintained at 13 per cent, because any further decrease might have had an unfavorable influence on the influx of foreign capital. The amount of discounts, which was 188 million schillings at the end of 1924, decreased continually in 1925,

[7] The "Kostgeschäft" was discontinued completely in January 1927, its place having been taken since by a form of operation in which all banks of issue engage, viz. report transactions in foreign exchange values.

though three successive reductions of the bank rate took place (on April 25 from 13 to 11 per cent, on July 24 to 10 per cent and on September 3 to 9 per cent), owing to the smaller requirements of industry, trade and commerce, to the stagnation on the Stock Exchange and to the influx of foreign short-term credits. The higher degree of liquidity of the banks, due partly to the growth of savings deposits also played an important rôle in this connection. The period beginning with January 1, 1926 and ending March 31, 1927, saw a continuation of this process, the amount of discounts declining in spite of five successive reductions of the bank rate (January 28, 1926 to 8 per cent, March 31, 1926 to 7½ per cent, August 7, 1926 to 7 per cent, January 18, 1927 to 6½ and February 4 to 6 per cent). On October 23, 1927, the amount of discounts reached the lowest level ever recorded since the Bank has come into existence, viz. 36 million schillings. Since then, it has been gradually — though intermittently — rising.

Discount Operations 1923–1926. The situation of the discount market is summarized in the following tables which show the year 1924 to stand out in every respect as a critical period. The number and the amount of bills discounted was far higher in 1924 than in the preceding year or in the years following, and so was the average period during which discounted bills were running and the percentage of bills protested for non-payment, while the percentage of bills arising out of purely commercial transactions was lower. As a rule, joint-stock banks, banking firms, savings banks, large public utility corporations, and a limited number of important industrial and commercial concerns only, discount bills with the National Bank direct. In the majority of cases industrial and commercial houses discount with a private banker or a joint-stock bank who in turn re-discount with the National Bank, if and when they require liquid funds. In 1925 and 1926, however, the banks have made very little use of this re-discounting facility and have generally held bills discounted by them up to their maturity. A private discount market to a small extent has also come into existence again. As there is an accumulation of funds, which are available for short periods at certain institutions (clearing establishments and some savings banks) prime bankers' acceptances can find accommodations

(In Austrian schillings)

Date	No. of bills held	Total amount of bills held	Average amount of one bill at end of each year	Average amount of one bill in the course of each year	Average period running in the course of each year
Jan. 1, 1923	19,072	77,935,519	4102	....	......
Dec. 31, 1923	28,935	132,331,291	4574	3813	64 days
Dec. 31, 1924	23,546	188,021,108	7985	6019	73 "
Dec. 31, 1925	23,887	180,249,536	7546	6389	56 "
Dec. 31, 1926	16,344	123,505,135	7556	6352	44 "
Dec. 31, 1927	16,038	131,712,257	8212	8422	33 "

Year	Highest		Lowest		Average during year
1923....	Dec. 31	132,337,000	Aug. 7	64,304,200	82,967,400
1924....	Aug. 7	332,856,500	Jan. 15	115,684,200	228,662,500
1925....	Jan. 7	182,407,000	Sept. 23	69,324,000	104,966,000
1926....	Jan. 7	166,568,000	Sept. 23	60,973,000	89,650,000
1927....	July 31	150,695,000	Oct. 23	36,082,000	82,760,000

Year	Amount of bills discounted	Of which protested	In per cent of total
1923..................	492,404,145	471,567	0.096
1924..................	1,174,115,293	19,170,766	1.649
1925..................	675,137,306	3,586,879	0.531
1926..................	723,650,341	8,049,039	1.112
1927..................	1,009,033,815	1,031,976	0.100

Date	Total amount of bills held	Of which commercial bills	In per cent of total
Dec. 12, 1923..........	107,505,000	76,004,200	71
Dec. 31, 1924..........	188,021,108	97,297,100	52
Dec. 31, 1925..........	180,249,536	109,720,000	61
Dec. 31, 1926..........	123,505,135	72,276,000	59
Dec. 31, 1927.........	131,712,257	85,091,000	65

at rates below the official rate of discount. The spread between the official and the private rate of discount varies in accordance with the law of supply and demand. When the money market was in a fluid state, as was the case during the larger part of 1925 and 1926, the private rate of discount was frequently as much as 1½ per cent below the official one. In view of the far-reaching consequences of a change in the official rate, the latter is, of course, not so quickly adaptable to all modifications of the situation. The number of firms eligible for accommodation on the private discount market is, however, extremely small and the total amount of transactions coming under this head is not important.

Year	Total No. of discounts	Under S 100	S 100 to 1000	S 1000 to 5000	S 5000 to 10,000	S 10,000 to 50,000	S 50,000 to 100,000	over S 100,000
1923	129,128	2492	40,006	54,075	20,489	10,279	1739	48
1924	195,054	983	68,575	75,014	27,643	20,594	1718	527
1925	105,669	855	35,491	41,491	14,989	10,941	1719	270
1926	113,930	1878	44,123	40,737	12,504	12,431	2165	95
1927	119,804	1888	46,814	40,912	13,978	11,057	5047	100

Compared with the discount of bills, the discount of securities plays an entirely subordinate part, as is shown in the following table.

DISCOUNT OF SECURITIES

(In Austrian schillings)

Year	Total amount of discounts (bills and securities)	Whereof securities	In per cent of total
1923	492,551,307	147,161	0.029
1924	1,174,401,298	286,005	0.024
1925	675,381,522	244,215	0.036
1926	723,842,495	192,154	0.026
1927	1,009,132,922	99,107	0.001

Loans and Securities. During a period of five years, beginning with the date on which the Bank commenced its operations, loans granted on securities (under Art. 57b) may be included in the commercial cover of the circulation. On the expiration of

this period the Ministry of Finance may order that such loans shall no longer serve as cover for the note issue but this has not been done so far. This period, however, must in no case be extended beyond the date on which specie payment is resumed. Beginning with November, 1925, loans have also been granted on certain bills of exchange which, though perfectly sound, were not suitable for discount under the present conditions (e.g. bills drawn on Russian purchasing organizations for goods exported to that country). The amount of loans on securities has also been very small in the course of the last five years, as is demonstrated by the following table.

LOANS ON SECURITIES

(In Austrian schillings)

Year	Average amount	Amount on Dec. 31	Exchange value on Dec. 31	Loan in % of exchange value
1923....	98,200	201,000	331,348	60.6
1924....	163,300	137,970	283,260	48.7
1925....	126,000	148,400	309,308	48
1926....	274,000	372,500	650,176	57
1927....	538,000	426,500	773,714	55

Current Account and Clearing Business. With a view to facilitating payments and to effect a saving in the actual circulation of instruments of payment the Bank opens current accounts to applicants (but may refuse the opening of an account or may give notice of an account already opened, without stating a reason), on which the respective firms are credited for sums of money, bills or securities paid in by them, or for their accounts, free of interest. From these credit balances the Bank effects for account of the respective firms transfers to other accounts, whether at the same place or not. It is also provided that, as a rule, the owners of such accounts are to make bills due by them payable at the National Bank. With the turnover effected through the current accounts the Bank participates to a considerable extent in the money clearing of the Wiener Saldierungsverein (Vienna Clearing Association), which consists of the large banks and credit institutions and prominent private banking firms (at present one only). The members of the Association have agreed to

clear day by day among themselves all sums of money due to them from, or owing by them to, other members of the Association. Balances remaining are settled through debits or credits passed on the current accounts of members with the National Bank. The amount of the total turnover on current accounts, as well as the highest, lowest and average amount of credit balances on current account is shown in the following table.

CURRENT ACCOUNTS (Giro-Verbindlichkeiten)
(In Austrian schillings)

Year	No. of accts. Dec. 31	Total Turnover	Average amount of Current Accts.	Highest		Lowest	
1923	1592	14,397,654,388	39,832,600	July 23	77,330,000	April 30	14,086,200
1924	1758	21,118,832,939	46,582,500	May 23	83,661,800	Dec. 15	17,852,600
1925	1514	30,002,200,167	29,925,000	Feb. 23	75,494,000	May 31	13,608,000
1926	1484	41,161,736,833	34,924,000	Nov. 23	69,606,000	Oct. 7	17,407,000
1927	1358	43,386,198,504	38,521,000	Jan. 23	82,150,000	Mar. 31	13,292,000

It is seen that, while the number of accounts and their average amount has remained comparatively stable during the last five years (with the exception of 1924), the turnover has risen very considerably (from 14 to 43 million schillings), thus indicating the largely increased use made of an institution destined to reduce the actual handling of money in commercial and financial transactions.

NOTE CIRCULATION. The current account liabilities of the Bank, together with the note circulation, are generally referred to in Austria as the " virtual circulation " and both items are on the same plane in regard to the provisions of the Bank statute determining the minimum amount and the nature of the cover to be maintained against these liabilities. The respective provisions of the statute have already been discussed in this section. When the Bank commenced operations, by far the larger part of the virtual circulation (over 57 per cent) was covered by government certificates of indebtedness (since January 1, 1923 transformed into a gradually redeemable Federal Debt), while somewhat over 16 per cent was covered by discounts and loans on securities.

The metal reserve (which largely consists of dollar and sterling

bills or credit balances in those currencies kept abroad and is therefore sometimes referred to as the " quasi-metallic " reserve) amounted to less than 27 per cent of the virtual circulation. The development of the five years following upon the formation of the National Bank has been characterized by a large increase of the virtual circulation in the year 1924 and further, though smaller, additions to it in the years following. This extension is not due to a corresponding increase of discounts which, apart from the temporary growth of this item in 1924, have risen only inconsiderably, while the Federal debt, which covers part of the circulation, has even been gradually shrinking, but to an increase of the metal or " quasi-metallic " reserve.

The International Loan obtained by Austria in 1923 placed at the disposal of the Government for certain specified purposes foreign instruments of payment which, as long as they were not required, remained in the keeping of the National Bank under the supervision of a specially appointed functionary of the League of Nations. When needed, a portion of the credit balance in foreign currencies was sold by the Government to the National Bank against Austrian bank notes, thereby swelling the " quasi-metallic " reserve and increasing the circulation. In a similar manner, which has already been referred to above, private enterprises sold to the Bank foreign instruments of payment, resulting from foreign credits obtained by these undertakings and the effect on the " quasi-metallic " reserve and on the circulation was the same as in the former case. The tables given hereunder demonstrate the mutual relation of the circulation and the various items which provide the statutory cover.

NOTE CIRCULATION

(All figures in Austrian schillings)

Year	Average amount	Highest		Lowest	
1923 ...	524,816,100	Dec. 31	712,575,500	Jan. 23	397,676,900
1924 ...	738,461,300	Dec. 31	838,776,700	Jan. 23	634,920,600
1925 ...	779,479,000	Dec. 31	890,000,835	Apr. 23	707,303,000
1926 ...	804,513,000	Dec. 31	947,321,000	Feb. 23	719,547,000
1927 ...	868,927,000	Dec. 31	1,005,315,000	Feb. 23	772,407,000

COVER OF CIRCULATION

Date	"Virtual" circulation (Notes plus Ct. acct. Liab.)	Quasi-Metallic Reserve*		Discts. & Loans on Securities		Federal Debt	
		Amount	%	Amount	%	Amount	%
Jan. 7, 1923	447,089,328	119,519,060	26.73	73,208,606	16.37	255,794,881	57.21
Dec. 31, 1923	777,517,958	391,530,919	50.36	132,538,000	17.04	253,449,038	32.60
Dec. 31, 1924	894,121,695	488,143,853	54.60	188,159,346	21.04	217,818,495	24.36
Dec. 31, 1925	945,033,918	573,193,000	60.65	180,603,483	19.11	187,942,566	19.89
Dec. 31, 1926	984,667,980	676,956,000	69.05	123,927,635	12.59	177,285,157	18.00
Dec. 31, 1927	1,044,911,000	737,886,000	70.62	132,138,000	12.65	173,188,000	16.57

COVER OF CIRCULATION
(Yearly averages)

Year	"Virtual" circulation	Quasi-metallic Reserve*		Discts. & Loans on Securities		Federal Debt	
	Amount	Amount	%	Amount	%	Amount	%
1923........	574,593,492	238,656,144	41.53	83,065,539	14.46	254,465,569	44.29
1924........	833,068,800	387,549,900	46.52	228,825,777	27.47	230,268,324	27.64
1925........	843,461,672	534,368,000	63.35	105,091,447	12.46	204,106,114	24.20
1926........	878,043,722	608,419,000	69.25	89,924,066	10.24	181,952,462	20.72
1927........	937,018,000	676,015,000	72.15	83,298,000	8.89	174,769,000	18.57

* Beginning with the year 1925 this item includes also those foreign bills on a gold basis which are not reckoned among the statutory metal reserve.

The Bank has the sole right of note issue in Austria, and up to the resumption of specie payments its notes are legal tender at their full face value for any amount except in cases where an agreement exists between parties to pay in hard coins or in any other specified manner. When the Government issues hard coins, the National Bank must, on demand of the Government, withdraw from the circulation notes equivalent to, and in the denominations of, the coins issued by the Federal Treasury.

THE "QUASI-METALLIC" RESERVE. Art. 83 of the Bank statute provides that the Bank has to accumulate a metal reserve enabling it to resume specie payments when a legal relation has been fixed of the Austrian currency to gold and when the Federal debt has been reduced to the amount of 30 million gold kronen (43.2 million schillings). When that moment will have come, the actual resumption of specie payments will be dependent on concurrent resolutions of the Federal Government and of the board

of the bank. Of these preliminary conditions the first was fulfilled on December 20, 1924, when it was enacted that one Austrian schilling (10,000 Austrian paper kronen) is to represent a quantity of 0.21172086 grammes of fine gold. Under the new gold parity 100 Austrian schillings are therefore equivalent to 14.07 U. S. dollars, or reciprocally, 100 U. S. dollars are equal to 710.66 Austrian schillings. About a year before the legal fixation of this parity of exchange the Austrian schilling, which had been pegged on the dollar, had been stabilized at very nearly the same rate. In regard to the other conditions for the resumption of specie payments, viz. the reduction of the Federal debt to 43.2 million schillings, it will probably be some years before the item in question can be so far decreased.

The Bank's initial stock of precious metals and foreign instruments of payment (foreign credit balances, bills and exchanges) was obtained in the following manner:

(a) through the subscription of the share capital..		S 31,378,646
(b) through taking over the reserve of the Oesterreichisch-Ungarische Bank		S 15,234,516
(c) through taking over from the Devisen-Zentrale the stock of foreign instruments of payment kept by the latter		S130,394,176
		S177,007,338
The National Bank, on the other hand, became responsible for liabilities in foreign currencies contracted by the Oesterreichisch-Ungarische Bank	S 5,779,215	
the Devisen-Zentrale	S 1,836,620	S 7,615,835
and the net amount of the "quasi-metallic" reserve with which the National Bank started therefore was		S169,391,503
of which		S 5,320,323
consisted of actual gold in bullion and coins.		

Increase in Gold Holdings. Though it was not intended by the Bank to convert the major part of its "quasi-metallic" reserve into actual gold, the amount of gold holdings has been gradually increased, absolutely as well as proportionally. Dur-

ing the first year of the Bank's existence the stock of gold rose by about 4 million schillings. From January 1, 1924 to the beginning of May, 1926, however, the increase was relatively small, amounting to about 5½ million schillings. From that date to the end of 1926 advantage was taken of the premium at which the Austrian schilling was quoted during that period against other currencies on a gold basis and gold was imported to a larger extent. The development of this item is shown hereunder.

Date	Gold in bullion and coins
Jan. 1, 1923	S 5,320,323
Dec. 31, 1923	S 9,332,612
Dec. 31, 1924	S 11,089,000
Dec. 31, 1925	S 14,830,000
May 15, 1926	S 18,313,000
July 31, 1926	S 37,619,000
Aug. 31, 1926	S 42,978,000
Sept. 30, 1926	S 46,830,000
Oct. 31, 1926	S 48,011,000
Dec. 31, 1926	S 52,506,000
Dec. 31, 1927	S 84,456,000
April 7, 1928	S117,198,962

Stabilization of the Exchanges. The Bank has been able to keep the exchange rate of the Austrian currency perfectly stable since operations were begun on Jan. 1, 1923. It would have been easy for the Bank to stabilize the rate of exchange at a higher figure, but the rate actually chosen, which was not far removed from the lowest figure to which the currency had dropped during the summer of 1922, enabled the Bank to accumulate a larger " quasi-metallic " reserve and to improve the ratio of the metallic cover of its bank notes. Other reasons (the expected unfavorable influence of a rigorous deflation policy on production and consumption) also played a part in determining this policy of the Bank. In the further course of events, in spite of a continually unfavorable balance of trade, the Bank was not only not obliged to sell foreign instruments of payment from its " quasi-metallic " reserve, but the latter, as has been shown above, has been very considerably increased. The sale of Austrian stocks abroad, the participation of foreign concerns in Austrian enterprises, and foreign credits were the source of this increase.

THE AUSTRIAN POST OFFICE SAVINGS BANK

Another institution which occupies a special position in the financial life of the country is the Austrian Post Office Savings Bank. Unlike the Austrian National Bank, it is, however, a Government institution owned by the State, the Federal Treasury being responsible to investors for the security of their deposits. The Post Office Savings Bank was established by law on May 28, 1882. Every post office in the country was authorized to receive from the public savings and other deposits and very large use was made of this facility. Savings depositors receive a booklet in which the original deposit, and any sums paid into the account at a later date, as well as interest accruing, are entered on the credit side and drawings on the debit side. The booklet has to be presented at the Pay Office of the Post Office Savings Bank (or of any post office) whenever depositors desire to pay fresh sums into their accounts or to draw on them.

Checking Accounts. In regard to current account deposits, upon which depositors may draw checks, the rule is that a certain minimum credit balance is always to remain with the Post Office Savings Bank, free of interest, as long as the respective account is open. These accounts are used primarily for the purpose of an internal clearing among the owners of Post Office Savings Bank accounts. As nearly every firm in the country has such an account with the Post Office Savings Bank, which in turn is in account with the Central Bank, the turnover of the institution is large and the saving in the circulation of actual money thereby effected considerable. In the pre-war time the Post Office Savings Bank invested its surplus funds in securities and was thus able not only to defray the costs, but to pay annually to the State a substantial sum.

The large amount of deposits coming from all parts of the Austrian Empire also enabled the Post Office Savings Bank before the war to play a leading part in the issue of Austrian State loans in conjunction with a syndicate of the large commercial banks. Altogether the arrangement was so successful that it was held up as a model of organization, and was imitated abroad.

The Post-war Crisis. A critical position was created through

the partition of the late Empire at the end of the war, when the institutions not only lost a large number of depositors owing to the fact that the new states established post office savings banks of their own, but because these states, as successors of the old Empire, preferred claims against the assets of the Austrian Post Office Savings Bank. These difficulties were enhanced through the conditions prevailing during the inflation period, when, on the one hand, the expenditure rose quickly, while, on the other hand, prudent investment, as had been practiced in normal times, became impossible, owing to the general instability of all values. It was unfortunate that the seriousness of the position was not realized at once, but at a time when stock prices rose by leaps and bounds there appeared to be no cause for anxiety and later public attention was centered on other economic aspects of grave importance. The slump of stock prices in the early summer of 1924 and the prolonged stagnation of the Vienna Bourse (1925 and 1926) had a very serious effect, however, on the situation of the Post Office Savings Bank. In the course of an inquiry it was revealed that the institution had lost extensively. The Government which guarantees the security of deposits then stepped in with a reorganization plan, which has since obtained the force of law.

Present Organization. Under the new arrangement the Post Office Savings Bank, which had been subordinate to the Ministry of Commerce (in view of the latter's responsibility for the post offices which act as pay offices for the institution) was transferred to the ministry of Finance, which supervises the Post Office Savings Bank through a State Commissioner, whose duty it is to watch over the strict observance of the statute, but who has otherwise no executive capacity. The Federal Treasury remains responsible for the present and future liabilities of the institution.

Administrative Organization. At the head of the Post Office Savings Bank is a Governor supported by two Vice-Governors, who constitute the Board of Management and who are appointed by the Federal President on the advice of the Cabinet. They are assisted by an Advisory Council (Kuratorium), consisting of twelve unpaid members appointed by the Cabinet for a period of four years. Four of the members must be appointed from a list

of candidates (three candidates for each vacant position) submitted by the Chambers of Commerce, and one member each from lists submitted by the Chambers of Labor and the agricultural central organizations respectively. Members must be Austrian nationals and have the qualification necessary for members of Parliament, though members of Parliament are not eligible, nor are members of the Federal Government, of a Provincial Government or of a Provincial Diet. The Council is convoked by the Governor, or by the acting Vice-Governor, as often as business requires it, but at least twice in every quarter-year.

Powers of the Council. The matters reserved to the Council are the fixation of the rate of interest payable on savings and current account deposits, the fixation of the commission charged on the clearing turnover, the enumeration of the kinds of securities in which the Post Office Savings Bank may invest, the determination in the case of loans on securities of the limit of such advances, the approbation of the annual balance sheet and of the estimate for the ensuing financial year, the general supervision of the management, etc. All resolutions adopted by the Council (except those referring to the approval of balance sheets and estimates and to the supervision to be exercised over the management) are subject to the approval of the Minister of Finance. A resolution moved by the Board of Management in the Council and not assented to by the latter can be taken to the Minister of Finance for his ultimate decision. Vice versa a resolution initiated in the Council and not assented to by the Board of Management can be treated in the same manner. The President of the National Bank has the right to attend all meetings of the Board of Management and of the Council with a consultative voice. If prevented from personal attendance, he may depute one of the Vice-Presidents, or the General Manager of the National Bank.

Nature of Business. The sphere of action of the Post Office Savings Bank is precisely defined in the statute to the exclusion of all and any transactions not specifically permitted therein. The transactions in which the Post Office Savings Bank may engage are:

(1) Participation in an issuing syndicate for the flotation of loans of the Federal Government, of the Federal Provinces, of

Municipal corporations and of such public funds which are under the administration of the Federal Government.

(2) The purchase and sale on commission of securities and foreign instruments of payment, if the value of the purchase is deposited with the Post Office Savings Bank in advance and if the securities or foreign instruments of payment to be sold are previously delivered to the Post Office Savings Bank.

(3) The collection on commission of securities and dividends due and of bills of exchange.

(4) The taking into safe-keeping for account of clients of securities and the administration of such securities.

(5) The purchase for the Post Office Savings Bank's own account of securities, stocks and foreign instruments of payment with the proviso that not more than 40% of savings deposits and not more than 15% of current account deposits may be employed in this direction.

(6) The granting of advances on securities which are in the safe-keeping and under the administration of the Post Office Savings Bank, provided these securities are listed on the Vienna Stock Exchange.

(7) The discounting of dividend coupons and of securities drawn for redemption, provided they are due within three months.

(8) The maintenance of credit balances with the Austrian National Bank and with other Austrian credit institutions approved of by the Council (Kuratorium).

(9) The discount of bills of exchange running not more than three months, which have already been discounted by a joint-stock bank, a banking firm, a savings bank or a credit association, provided these bills can be re-discounted with the National Bank.

(10) The discount of warrants issued by public warehouses and falling due within three months is also permitted but plays no rôle whatever in Austria.

As stated above, at the time of the reorganization a considerable deficit existed, which was covered only by the State guarantee. As long as this deficit is not worked off entirely (i.e. as long as a claim can be made against the State) and a reserve fund amounting to at least five per cent of the aggregate savings and current account deposits is not accumulated, the Minister of

Finance may reduce the percentage of funds to be invested in securities and foreign bills (see above) and may fix the percentage of funds to be employed in other directions.

Deposit Business. The deposit business of the Post Office Savings Bank has not been modified under the new statute with the exception of one innovation in regard to savings deposits. The new statute authorizes the opening of savings bank accounts which, bearing interest at a lower rate than the one credited on ordinary savings accounts, participate in a lottery instituted among this class of depositors. An ordinance of the Minister of Finance issued on March 21, 1927, lays down the lines along which the scheme is to be worked. The savings booklets in question must be for a certain amount, called the " premium deposit," determined under the lottery plan and must not be withdrawn within one year. Should the amount of the total deposit on a savings booklet of this class exceed the " premium deposit," the latter only participates in the lottery, while depositors are allowed the ordinary rate of interest on the surplus. The savings deposit business of the Post Office Savings Bank is largely from small investors, whose savings habit it is intended to encourage in this manner.

Importance of Savings Accounts. The relative importance of the Post Office Savings Bank in regard to the savings deposit business has declined to some extent in the course of the last years (compared with the development of this branch in the case of other credit institutions), but in view of the fact that the Post Office Savings Bank has particular facilities for attracting the small investors through the great number of post offices, which all act as pay offices to the institution, its rôle in this respect is still considerable and may very likely grow, when conditions in this country become further stabilized.

Clearing Accounts. The current account and the clearing branch of the Post Office Savings Bank has also a special part to play. It is, above all, an institution for the clearing of sums of money which are small individually and almost all small and medium-size firms as well as many tradespeople make use of this facility. As large firms have also accounts with the Post Office Savings Bank, however, and as the latter, in turn, is in account with the National Bank, there is a complete system of communi-

cation of internal money exchanges, comprising nearly all firms, large and small.

The turnover of the Post Office Savings Bank on clearing accounts is considerably below the one of the National Bank owing to the fact that the individual average amounts cleared are smaller. A comparative table of the turnovers of the Austrian clearing institutions will be given at the end of the paragraph dealing with the third special organization of the Austrian credit system, namely the Wiener Giro- und Cassen-Verein.

THE WIENER GIRO- UND CASSEN-VEREIN

This is a joint-stock company formed in 1872 by the large Austrian banks and some prominent private banking firms, which hold nearly all the shares. Its primary object is to clear the Stock Exchange transactions effected on the Vienna Bourse not only with a view of avoiding as far as possible the actual circulation of money, but also the bodily transfer of shares. All stock exchange transactions effected on the Vienna Bourse, unless specifically agreed otherwise among the parties, are cleared through the Wiener Giro- und Cassen-Verein. All firms and persons doing business on the Stock Exchange participate in the clearing. They have to notify the Wiener Giro- und Cassen-Verein on special sheets supplied by the latter of all purchases and sales effected during the week, stating the number of trading units purchased or sold, the name of the seller or buyer and the price at which the transaction has been made. These sheets are grouped by the Wiener Giro- und Cassen-Verein under the various securities and, in every description, in the alphabetical order of the firms concerned.

Stock Clearances. All transactions which have taken place during the week in any kind of securities are deemed to have been effected at a medium price (Liquidationskurs), which is fixed by the Vienna Stock Exchange Committee and on every sheet submitted by the participants in clearing the difference between the medium price (Liquidationskurs) and the price at which the sale or purchase has actually taken place is computed

for every single item. A balance of securities due to, or owing by, any participant is to be delivered at the medium price (Liquidationskurs). As a rule, no bodily transfer of stocks and securities has to take place for settling the stock balance, as members keep deposits of securities with the Giro- und Cassen-Verein and the transfer is therefore simply effected through a credit or debit passed by the Wiener Giro- und Cassen-Verein on the accounts of the respective firms. The deposits of securities are literally " drawn upon " by the members in their dealings with the Giro- und Cassen-Verein, i.e. so-called " EFFEKTENSCHECKS " (stock checks) are used which resemble the customary money checks in every respect, except that they do not call for the payment of a sum of money to the drawee but for the transfer to him (or to his account) of so many trading units of a certain stock.

Settlement of Money Balances. In addition to the balances of stocks and securities there are differences of money also to settle. The firms taking part in the clearing receive from the Giro-und Cassen-Verein debit notes or credit notes, as the case may be, with the difference (between the medium price or " Liquidationskurs " and the price at which the operation has been actually transacted) owing by or due to them. Their money balances are also settled through a clearing either by a check on a credit balance with the Giro- und Cassen-Verein or with the National Bank, the Post Office Savings Bank or a private joint-stock bank.

TURNOVERS ON CLEARING ACCOUNTS
(In schillings)

	1923	1924	1925	1926
National Bank........	14,397,654,388	21,118,832,939	30,002,200,167	41,161,736,833
Post Office Sav. Bk. ...	3,610,118,952	5,698,034,238	15,802,388,808	17,488,667,214
Saldierungs-Verein	1,442,885,464	1,975,385,122	1,928,476,440	2,380,398,269
Giro- und Cassen-Verein	19,976,231,100	17,075,704,760	15,109,222,010	28,433,663,915

THE COMMERCIAL BANKS

The characteristic features of Austrian banking have already been briefly described in the first section of this chapter, where an historical survey has been given of the origin and the growth of Austrian commercial banks, from which it will have been apparent that, though the various banks may, in a limited degree, specialize in certain branches, there is no fundamental distinction in Austria between commercial banks, properly so called, and investment banks, or even between these two and agricultural credit banks, though the function of extending mortgage credit to rural proprietors is at present combined with the other branches of banking in one Austrian institution only.

Credit Operations. Credit transactions in banking are generally roughly divided into two categories, according to whether the bank is a creditor (active business) or a debtor (passive business) towards the client. A classification under these two heads cannot, of course, exhaust the enumeration of cases in which the banks have an important part to play, as it leaves out of account not only the numerous instances in which the banks act in a neutral capacity (on commission) or as dealers, but also the financing and issuing business. As regards the regular and current banking business, however, the above distinction is of some advantage and shows the lines along which a systematic discussion could be conducted. It is logical to commence with the so-called passive business, where the banks are borrowers, as it supplies the funds (in conjunction with the bank's own means) for the active business in which the banks act as lenders. In the following paragraphs the usual forms of operations will be described and mortgage business, though at present engaged in by one commercial bank only, will also be included.

Current Account and Savings Deposit Business. The banks accept deposits in the currency of the country and in foreign currencies, which can be withdrawn at sight or after the expiration of periods previously agreed on between the bank and the depositor (one, two or three months). Depositors are either credited on current account in the case of sight deposits or they receive interest-bearing certificates (Kassenscheine), which are issued in round figures and run for certain periods (one or several months).

Savings deposits against savings booklets are also received and in this case the minimum amount to be paid into the account and to be left there as long as the account is not totally withdrawn, is generally fixed at 100 schillings.

To facilitate the compensation of payments in Austrian currency " Giro " accounts are opened on demand. Correspondence between the bank and the client in regard to the transactions on such accounts is generally dispensed with, the client receiving a booklet which he presents at the counter after a payment has been made into the account and the bank clerk enters the respective credit item in the booklet. Debit entries, for sums drawn upon the account, are made by the client himself. The number of such accounts is comparatively small, as the majority of firms use their ordinary current accounts for this purpose in view of the frequent occurrence of transactions in foreign currency, which are too complicated to be handled under the simpler scheme of " Giro " accounts.

Growth in Current Account and Savings Deposits. This form of business was current before the war, but, so far as inland accounts were concerned, it nearly disappeared during the inflation period, when, owing to the rapid depreciation of the krone, nobody kept larger sums available in the Austrian currency than were indispensable, while it was nearly impossible to obtain deposits in foreign currency. Since the beginning of 1923 (i.e. since the stabilization of currency) it has, however, grown quickly, owing partly to the increase of savings deposits in the country and partly to foreign short-term credits being offered to Austrian banks on a large scale. The aggregate amount of Current Account Creditors (foreign and Austrian) and of savings deposits in six Austrian banks (Wiener Bankverein, Allgemeine Oesterreichische Boden-Credit-Anstalt, Oesterreichische Credit-Anstalt, Niederoesterreichische Escomptegesellschaft, Zentral-Europaeische Laenderbank and Mercurbank) at the end of 1923, 1926 and 1927 was as follows:

	In schillings (000's omitted)	
	Current Account Creditors	Savings Booklets and Certificates
Dec. 31, 1923	857,935	16,916
Dec. 31, 1926	1,977,334	263,120
Dec. 31, 1927	3,297,567	380,574

This growth of the outside capital placed at their disposal enables the banks to grant credits on a larger scale than they did in the first years after the stabilization of the currency. No comparison with the figures during the inflation period is possible in this or in any other respect owing to the fact that at different dates during that time the Austrian krone represented vastly different values.

Short Term Character of Credit Extensions. In accordance with the short-term character of these transactions, in which the banks are borrowers, the balancing lending operations are also mostly of a short-term nature. The most usual form they take are credits extended to industry and commerce in current account. They are either personal or secured credits. In the latter case the security may consist in a deposit of stocks or bonds, in a mortgage on the property of the debtor or in a guarantee of a third person. Credits granted in current account are formally always of a short-term character, but due consideration is given to the requirements of the client's business and in the case of sound firms the credit is frequently renewed.

Interest Charges on Overdrafts. The mode of charging interest is, of course, readjusted from time to time in accordance with the general economic situation of the country and with the conditions prevailing on the money market but, speaking generally, in the course of the last few years the interest (properly so called) on overdrafts has been from 1% to 1½% above the official bank rate. Since the middle of 1920 an "advance (or overdraft) commission" has also been debited at rates which are changed when the general situation warrants a modification. At the present time it amounts to 1% per quarter-year. Commission at varying rates (according to the nature of the account and the standing of the respective firm) is also charged per half-year on the side of the account where the turnover is larger. The date as from which clients are credited for values paid into the account is one working day after the receipt of the payment.

Discount Business. Another important form is the discount credit, the main objects of which are bills of exchange. Bills running for 100 days or less are discounted at present at the official rate (bills running for a longer period at correspondingly higher rates) if the transaction is passed over current account,

on the turnover of which commission is chargeable. Otherwise the rates of discount are, as a rule, 1 per cent higher. The discounting of open (book) accounts was likewise practiced to a considerable extent by some banks before the war and is now slowly reviving.[8]

It has already been observed in another section of this chapter that owing to various circumstances the discount business has always been smaller in Austria than in other countries and that since the successful reorganization of the currency system recourse to foreign short-term loans has been had in many cases as a substitute to making use of discount facilities.

Loans on Securities. Transactions of the kind referred to above constitute an intermediate form between the discount business properly so called and loans given on securities, stocks, bills of exchange and other values which are also now less frequent than they were in former times owing to the depreciation and the instability of stock exchange values. Interest payable on such

[8] While the other forms of discount credit are familiar to students of banking in other countries, the discounting of open accounts may require some additional explanation. Smaller and medium size firms chiefly avail themselves of this facility. The method generally adopted in such cases is best illustrated by an example. Take the case of a manufacturer who sells his goods to customers on three or six months' credit. He may not possess a capital sufficient to allow him to produce continuously, if his outstanding debts are paid to him with a delay of three to six months. If the manufacturer in question wishes to have recourse to discount credit, it cannot be, in many cases, on the basis of bills drawn by him on and accepted by his customers, in view of a certain prejudice on the part of the clients against the acceptance of bills, but only on the basis of his book claims against them. In such cases he supplies the bank with a list of the open accounts (showing the dates and amounts of invoice, as well as the names and addresses of the firms to which goods have been supplied), which he wishes to discount. The invoices on the list are formally ceded to the bank and in the books of the firm which cedes them, the respective items are rubber-stamped to that effect. The clients of the manufacturer, however, are not invariably notified of the cessation, and they, therefore, at the maturity of the invoices, sometimes settle them to their supplier direct, who in turn hands over the remittances to the bank. When the cession is made, the manufacturer in question, as a rule, signs an acceptance to the bank for the total amount, or else he draws on the bank for the amount in question and these bills of exchange are then discounted, the proceeds being at the disposal of the manufacturer. If one or several of the firms on the list should become insolvent, the manufacturer will cede to the bank other invoices of a like or higher amount to take the place of those whose settlement in full cannot be reckoned upon.

loans, as a rule, exceeds the rate charged on discounts by one per cent. It is generally the case that this special form of credit is made use of as a collateral security in current account credits on the turnover of which, in addition to interest on the overdraft pro rata temporis, commission is also charged.

Guaranty Credits. Special forms of credit are represented by the so-called guaranty credits, under which the bank assumes liability on behalf of its clients towards a third party for the payment under specified conditions of a certain sum of money. The bank, in such cases, is, as a rule, fully covered for the amount of the liability assumed, which may be for instance towards the Customs Administration, the Taxation office or the Federal Railroads for the payment of customs, taxes, or freight charges due to the respective body or authority. Customs and railroad (freight) guaranty credits are at present handled by the Wiener Giro- und Cassen-Verein on behalf of the large banks jointly.

Mortgage Business. Mortgage business, as a special branch of banking (as opposed to mortgages used as a collateral security in the current account business of the banks and referred to in a previous paragraph), is at present engaged in on a large scale by one commercial bank only (the Allgemeine Oesterreichische Boden-Credit-Anstalt), but other types of financial institutions, the Provincial Hypothecative Institutions (Landes-Hypotheken-Anstalten) whose organization will be discussed later, specialize in this branch. The savings banks also invest a considerable portion of their deposits in mortgages, but they do not in all cases issue their own mortgage bonds, as do the Boden-Credit-Anstalt and the Landes-Hypotheken-Anstalten.

Decline in Importance of Mortgage Credit. Before the war mortgage credit occupied a much larger space in the economic life of the country than they do now. The currency inflation, which began at the outbreak of the war, together with the large nominal profits made by industrial and agricultural producers during the war, made it possible to repay hypothecary loans in depreciated currency before the expiration of the period for which they had been granted. After the stabilization of the Austrian currency (end of 1922) mortgage credit came into use again, though on a much smaller scale than in the pre-war period, the

reduction of the volume of business being due in the case of rural mortgage credit to the high rate of interest ruling, which made it undesirable for the farmer to burden himself with large annuities, unless the nature of the work to be financed by the aid of mortgage credits was indispensable. In regard to mortgage credit on urban estates, it is still practically non-existent, owing to the operation of the Rent Restriction Act. The so-called " house repair credits " will be referred to in the section dealing with the savings banks.

The Land Register. Before entering upon a discussion of the methods employed in the mortgage credit business, reference must be made to an institution (the " Grundbuch " or Land Register) which exists in Austria, but whose exact counterpart is not to be found in all other countries.

The Land Registers are public books in the keeping of the tribunals, where the legal conditions governing all real estate in the respective district (proprietorship, debts secured on these estates, transfer of rights, etc.) are officially entered. The Land Registers are accessible to all persons desiring their inspection. A transfer or a cession of rights on real estate is valid only after having been entered on the Land Register. This refers, of course, to the mortgaging of land as well. If several mortgages are entered on the same estate, they rank in the order in which they have been tabulated. The institution described above, on a prudent estimate of the value and yield of the real estate, offers a secure basis for mortgage credits and reduces to a minimum the risk of the lender.

Valuation of Real Estate. The rules followed in estimating the value of real estate are very strict and the valuation is generally much, sometimes as much as 50 per cent, below the market price. In the case of agricultural land, the loans amount to one-half and in the case of vineyards and land under forests to one-third of the *estimated* value. In the Land Register the loan must be entered *primo loco,* i.e., no other claim on the estate may take precedence of the loan. The bank (or the Landes-Hypotheken-Anstalt) has the right to issue mortgage bonds of a nominal value equal to the loans granted by the institution.

Issuance of Mortgage Bonds. As only such funds are, as a rule, available for mortgage credit, as can be obtained through

the issue of mortgage bonds, the latter must be of a nature to make them easily marketable, i.e., their price and yield must make them attractive investments. From the issuing price and yield of mortgage bonds depends the interest payable by the mortgage debtor. The rate of interest must include the interest payable by the issuing institute to the mortgage bondholders, the expenses of the former and an adequate profit. The sum actually paid to borrowers is below the nominal amount of the loan, because the issuing institute cannot be quite sure that the price of its mortgage bonds, when issued, will be as high as anticipated.

Cost of Mortgage Credit. In a normally functioning market mortgage bonds issued by sound institutions are much in demand as first rate investments. The rate of interest payable on them is therefore below the rate of other bonds, while the market price is generally near par. At the present time, however, when owing to the war and the events following it the amount of capital available for such investments in Austria has been largely reduced, while foreign capital is not always familiar with the institution of mortgage bonds, the latter, to make them attractive, must carry interest at a rate above the National Bank's rate of discount. Owing to these circumstances, mortgage credit is at present considerably dearer than it was before the war, and can be made use of only for highly remunerative purposes. It is clear that, if the charges to the borrower are to be lightened, the market price of mortgage bonds must first rise. This will be the case when, with the gradual reconstitution of Austrian capital available for such investments, the conditions on the bond market become normal again. A clause is inserted in mortgage agreements providing that the loan can be repaid by the debtor before the expiration of the period for which it has been granted. In the case of an improvement of the mortgage bond market the debtor can therefore convert his loan into one entailing less heavy interest charges.

NEUTRAL OPERATIONS

Foreign Exchange Business. In foreign exchange business the banks generally act in a neutral capacity, i.e., neither as bor-

rowers nor as lenders. If foreign instruments of payment are sold or purchased for account of a client, the banks do so either on commission or as dealers. The profit to the bank, apart from the one made on the rate of exchange, results from interest accruing to the bank on the interval between the dates as from which debit is passed and credit given to the customer's account. Credit for values received is given to the client one working day after the respective value has been paid into the account. Commission is charged, besides, if the purchase or sale is made against Austrian currency. In many cases, however, one foreign currency is sold against another (Usancegeschäft) and this is especially the case in arbitrage operations.

Stock Exchange Business. In like manner stock exchange transactions are carried out by the banks either on commission or as dealers. Purchases and sales of stocks and securities are, as a rule, debited or credited to the current account of the clients. The kinds of stock exchange operations usual on other markets also occur in Austria with slight variations. The profit to the bank results from the gain made on the stock prices, as well as from commission charged to the clients on each buying or selling operation.

Money Transfers. The transfer of money and the facilitation of money exchanges also belong to the sphere of current banking. Payments are made or received for the account of clients on current account, checks and bills of exchange are collected or paid by the bank on instructions from its customers, and documentary or other credits opened for them at other places or honored for them in Austria. The latter credits may be revocable within the period for which the credit has been arranged (unconfirmed credits) or irrevocable (confirmed credits). The profit to the bank consists in the commission charged on each transaction.

Bank Charges. In regard to the terms on which the banks are doing business with their clients, an agreement (Konditionen-Uebereinkommen) exists between the larger joint-stock banks and a few private bankers, under which certain minimum charges are laid down for interest and commission debited, and maximum rates for interest credited to clients. Differences are made according to the standing of the customer, to the smaller or lesser

amount of the turnover and to the period during which a credit is required. The agreement provides for a number of exceptions in regard to transactions in which both parties are banks. Among those banks, which were established during the inflation period and which enjoyed an ephemeral existence only, some did not adhere to the cartel, while others evaded it where possible, especially in regard to the rates of interest allowed on deposits, in their desire to attract customers in competition with other institutions. The purification process in the Austrian banking organization, which commenced in 1924 as a result of the financial crisis of that time, and which did away with a large number of banking establishments, as well as the movement towards greater concentration, which became noticeable in 1926, has made the agreement generally observed.

The Financial Crisis of 1924. It is necessary in this connection to dwell at some length on the crisis of 1924 and its consequences to the Austrian banking organization. As has been explained elsewhere in these pages, a speculative frenzy took hold of the population during the inflation period and stock exchange gambling seemed to them a sure method of acquiring riches rapidly, apart from the fact that many people saw no other way of safeguarding themselves against the effects of the currency depreciation. Not only had the old established banks to work hard to carry out all the stock exchange orders transmitted to them by their clients, but there appeared to be room for new banks and banking houses too. As a consequence, a large number of such companies or firms came into being and the management of many of them was entirely devoid of any knowledge of banking. In a market which had been almost constantly rising for years, in consequence of the currency depreciation, the only prerequisite for achieving success was thought to be reckless and indiscriminate buying. The ordinary methods of discount policy were of no avail in discouraging this activity, as speculators found it remunerative to pay any amount of interest in order to carry on the game, and an increase of the bank rate would have been immediately overtaken by the rise of stocks caused by every fresh plunge of the krone. As a matter of fact, some well-known speculators achieved fabulous riches then and, through cornering the market for certain stocks, were able to force their way to the

presidencies of solid banks and important industrial companies, much to the detriment of those enterprises. Owing to a peculiar combination of circumstances, the economic depression which generally follows the stabilization of a currency (the stabilization was practically effected at the end of 1922) did not make itself felt in the country at once and the seemingly favorable state of national economy encouraged a further rise of stock prices, which continued up to the end of 1923.

Collapse of Speculative Boom. The spell of good fortune of gamblers was broken, however, in the early part of 1924, when, owing to the failure of a widespread speculation against the French franc, which entailed heavy losses, a slump occurred on the Stock Exchange, which grew to very large proportions and was mitigated only to a small extent by the formation of a Supporting Syndicate of the larger banks. In consequence of the rapid decline of stock prices a large number of the newly established banks and banking firms failed, partly owing to the fact that their clients, who had largely engaged in margin purchases, were unable to settle their accounts. Even two of the older banks, the Allgemeine Depositen-Bank and the Lombard- und Escompte-bank, which, in the time before the war, had occupied an honorable position in the Austrian financial organization, found themselves unable to meet their obligations and became bankrupt.

The Concentration Movement. Through the disappearance of many financial enterprises the Austrian banking organization found itself, at the end of 1924, relieved of much parasitical growth, though at a considerable cost to the community. The shrinkage of business owing to the stagnation of the Stock Exchange induced the remaining banks to contemplate a concentration policy, which bore its first fruits towards the middle of 1926, when the branches of the Anglo-Austrian Bank in the country were taken over by the Oesterreichische Credit-Anstalt. A further step was made at the beginning of 1927, when the Oesterreichische Boden-Credit-Anstalt absorbed two other banks (the Verkehrsbank and the Union-Bank). As another bank, the Centralbank der deutschen Sparkassen, had to stop payments in the middle of 1926, under circumstances which resembled those witnessed in the case of the inflation banks, the number of the more important commercial banks in Vienna has been reduced to six,

among which is one foreign institution and one medium-sized bank.[9] There is still a number of smaller joint-stock banks in Vienna and in the provinces, in addition to the above-mentioned six institutions, and, to all appearance, the size of the Austrian banking organization is now proportionate to the requirements of the country and to the rôle played by Vienna as a financial center in the Danubian States. A further reduction of the number of banks through fusions of two or more institutions is not now necessary, as it was three years ago, especially in view of the fact that the remaining banks have gained to a considerable extent by the disappearance of some of their weaker competitors.

Credit Balances and Overdrafts. A thing which generally strikes observers of Central European banking conditions is the very considerable spread between the rate at which a yield is obtainable by clients on credit balances and the rate at which they have to pay the bank (in the shape of interest and of commission) for overdrafts. It has been said above in regard to Austrian banks that the terms on which they do business with their clients depend to some extent on the nature of the accounts. No definite figure applicable to all cases can therefore be given for the amount of the difference between the costs to clients of overdrafts and the yield they obtain on credit balances. This difference is due largely to circumstances beyond the control of the banks and has grown naturally out of the conditions which have developed here since the end of the war. Seven different currencies came into existence then on a territory where the Austrian krone had been the only means of payment and this necessitated a multiplication of accounts, while, at the same time, the aggregate turnover on these accounts has been greatly reduced, compared with the former volume of business.

Increase in Bank Costs. The legal provisions of the Peace Treaty, in so far as they referred to the accounts of foreign nationals (including under this term the citizens of the Succession States), caused likewise a great increase of work. All these consequences were magnified by the fact that, in view of the depre-

[9] There exists besides the Credit Institut Für Öffentliche Unternehmungen und Arbeiten (Credit Institute for Public Utility Works) in which the government and the large banks have an interest, but its sphere of action is limited chiefly to the financing of the enterprises referred to in its style.

ciation of the krone and of other European currencies, all transactions had to be expressed in colossal figures. If it is taken into consideration that for a tiny amount, which in the United States would have required the entry of *one* figure, the entry of from *five* to *six* figures was necessary in Austria (e.g., $9.— in America and its equivalent, namely 630,000 kronen in Austria) this effect of the inflation will be better appreciated. Further, the desire to invest available funds in stocks in order to protect them to a certain extent from the depreciation brought in its wake a large increase of Bourse transactions. All these circumstances combined compelled the banks to make considerable additions to their staffs. When in 1924 most of the above-mentioned circumstances ceased to operate, the banks were left with large numbers of employees, whom they could not discharge, though there was hardly enough work to go round, without paying to them compensations, amounting in the aggregate to very large figures. Such compensations were required partly under Austrian labor legislation and partly under agreements which the banks had had to enter into with the bank clerks' trade union. This expenditure, in conjunction with heavy taxation, increases the working costs of the banks and makes drastic reductions of charges difficult. Still, reductions were made and, if measured on the rates which were in force in 1924, they have been considerable. At each successive lowering of the official rate of discount the banks have allowed the full amount of the reduction to become effective in regard to overdrafts, while the rates of interest on credit balances have been lowered hesitatingly only and not to the full extent. The manner of charging "advance" commission (Vorlage-Provision), which really is an element of interest under another name, has also been modified so as to constitute a saving of expenses to the debtor. At the present time the retrenchment process is already far advanced and in many cases a large amount of routine work is now done with the aid of modern machinery.

THE PECULIAR CHARACTER OF AUSTRIAN BANKS. Attention has been drawn in the historical survey to the particularly close relationship in which the commercial banks stand to the productive life of the country and the conditions under which the relationship has grown up have been outlined. The commercial banks, as has been explained, are large and in many cases the principal stock-

holders in a great number of financial, industrial and commercial enterprises and therefore partake to a considerable extent of the character of Investment Trust Companies. The financing branch of the bank business, which was important before the War and has grown to large dimensions during the inflation period, when most existing companies had to issue fresh stock at relatively short intervals and when, besides, a considerable number of new companies was formed, has been stagnant since the crisis of 1924.

Degree of Liquidity. The large investments of the banks in Austrian and foreign stocks — under foreign stocks chiefly those of companies in the Succession States are referred to — the fact that the Austrian commercial banks combine a number of functions which in some countries would not be united in the same institution and finally the degree to which the banks finance the industrial and commercial undertakings in Austria, must be taken into consideration if the degree of liquidity of the Austrian banks is judged. Under the circumstances it cannot be as great as in Western European deposit banks, but such as it is, the existing degree of liquidity has been found to be adequate even under very trying and critical conditions.

Balance Sheet Relations. The relative importance of the various items on the assets and liabilities side of bank balance sheets is shown, and a comparison between the last pre-war years and the year 1925 made possible, by the following table, which gives the items for the two years in question in percentages of balance sheet totals. A second table institutes a comparison between the items of the profit and loss accounts. As regards the period intervening since the outbreak of the war and the publication of the first gold balance sheets (as per December 1, 1925) no comparison can be made, as the depreciation of the krone casts a veil over this period which it is very difficult, if not impossible, to penetrate. A transaction entailing a loss would often appear in the light of a lucrative operation. E.g., stocks purchased at 10,000,000 kronen (when this amount represented $500) and sold at 20,000,000 kronen (which at the time of the sale would have been worth $280) would leave a seeming profit of 10,000,000 kronen, while the transaction, if recorded in a stable currency, would really have shown a loss of $220. It is clear that under such conditions, no valid deductions can be drawn from the bal-

PRINCIPAL ITEMS OF BALANCE SHEETS (in per cent of balance sheet totals)

Liabilities	Share capital		Reserves		Creditors		Sav. deposits		Acceptances		Net profit	
	1913	1925	1913	1925	1913	1925	1913	1925	1913	1925	1913	1925
Bankverein	14.1%	11.9%	4.1%	5.9%	56 %	71.2%	13.4%	9.4%	9.2%	.....	1.4%	1.3%
Bodencredit Anstalt	5.8%	7.6%	12.9%	5.1%	30.7%	80.2%	......	.....	.....	0.8%	1.6%	1.5%
Credit Anstalt	12.7%	8.2%	7.9%	3.2%	66.4%	79.8%	6.8%	7.5%	4.3%	0.2%	1.8%	1.1%
Escompte Ges	17.4%	10.2%	6.1%	6.1%	58.9%	77.3%	6.4%	4.3%	9.5%	.....	2.4%	1.7%
Mercur Bank	17.6%	9.3%	7.8%	3.1%	50.9%	76.7%	15.2%	9.9%	3 %	0.3%	2.1%	1.3%

Assets	Cash in hand		Discounts		Loans on securities		Securities		Debtors		Loans on mortgages	
	1913	1925	1913	1925	1913	1925	1913	1925	1913	1925	1913	1925
Bankverein	3.2%	3.3%	23.9%	14.3%	5 %	....	3.1%	7.2%	56.5%	70.5%	.....	....
Bodencredit Anstalt	0.9%	2.1%	11.5%	11.4%	2.8%	....	3.6%	9.2%	35.5%	63.6%	44.5%	4.8%
Credit Anstalt	2.6%	1.9%	17.1%	6.8%	4.3%	....	3.9%	6.3%	63.9%	79.6%	.....	....
Escompte Ges.	1.7%	4.3%	15.4%	7.8%	2.5%	....	1.7%	1.4%	66.6%	76.2%	.....	....
Mercur Bank	2.4%	4.6%	12.3%	7.2%	2.5%	....	2.9%	2.2%	72 %	76.7%	.....	....

PRINCIPAL ITEMS OF EXPENDITURE (in per cent of gross receipts)

	Salaries		General expenses		Taxes and dues		Net profit	
	1913	1925	1913	1925	1913	1925	1913	1925
Bankverein	27 %	55.2%	11.8%	11.5%	9.8%	13 %	46.5%	14.4%
Bodencredit Anstalt	8.3%	33.7%	......	4.8%	8.3%	22.5%	40 %	33.6%
Credit Anstalt	16.3%	52.3%	7.1%	7.8%	11.9%	12.7%	53 %	20.9%
Escompte Ges.	11.9%	26.5%	1.5%	5.7%	13.3%	26.7%	70.9%	36.3%
Mercur Bank	17.8%	49.5%	12 %	8.4%	11.2%	20.9%	52.5%	17.8%

ance sheet figures published during the inflation period. The Gold Balance Sheet Act of June 4th, 1925 made an end of this confusion by breaking the continuity of balance sheets and ordering their establishment on the basis of a fresh valuation of all items. These provisions were complied with for the first time in the balance sheets published for the year 1925.

Capital Funds 1913–1925. As has already been set forth, the banks had to proceed with fresh capital issues at frequent intervals during the inflation period. From the following table, comparing the share capital and the reserves of the principal banks in 1913, 1925 and 1927, it will be seen, however, that the capital plus reserves is much lower now than before the war, which means that, among other values, the capital raised during the inflation period has been completely lost. It is impossible to state the amount of the capital issues during the era of depreciation in terms of a stable currency, owing to the circumstances alluded to in the previous paragraph.

Capital and Reserves of five leading banks
(in schillings, 000's omitted)

(The figures for 1913 have been converted from gold kronen to schillings)

		1913	1925	1927
Bankverein	Capital	187,200	40,000	55,000
	Reserves	54,956	20,000	26,428
Bodencredit Anstalt	Capital	77,760	30,000	55,000
	Reserves	172,621	20,000	32,000
Credit Anstalt	Capital	216,000	50,000	85,000
	Reserves	134,807	20,000	33,225
Escompte Ges.	Capital	108,000	37,500	37,500
	Reserves	36,555	22,500	25,414
Mercur Bank	Capital	72,000	12,000	12,000
	Reserves	31,680	4,000	4,100

The capital of the banks consists of the share capital, which is in all cases fully paid-up, and the reserves. One kind of shares (common stock) only is in use. In regard to the reserves, the law requires five per cent of the annual net profits of a company to be paid into an ordinary reserve fund, until the latter reaches 10 per cent of the share capital. This reserve fund is not to be drawn upon, except to meet a loss. Special reserve funds

are also accumulated by Austrian companies out of allocations made from the net profit and no legal limitation exists as to the use to which they may be put.

Secret Reserves. The desire of the banks to be on the safe side, wherever possible, in the establishment of balance sheets led to the practice of putting extremely moderate valuations on their realizable assets. To some extent this policy may also have had its origin in the desire to make the effects of a bad year less generally noticeable from balance sheets, and it enabled the banks in many cases to meet losses and increase dividends without a recourse to the declared reserves. The practice had to be interrupted during the inflation period, which made a reliable estimate of assets impossible, but it has been resumed since. A certain amount of hidden reserves, which in some cases considerably exceed a normal safety margin, is therefore frequently contained in the values of balance sheet items.

The Licensing of Banks. In regard to joint-stock banks, as in regard to stock-companies generally, a licensing system is in force, and a company can be formed only after its articles of association (the statutes) have been approved of by the proper authorities. The Government delegates a State Commissioner to the meetings of the Board and the Commissioner has the right to veto decisions which are contrary to the law or to the statutes of the bank. Bank managers are legally responsible (jointly and severally) for the good administration of the company, though in the cases of banks which failed after the crisis of 1924, it has not been possible to make this legal responsibility effective to the extent of improving the fate of those who had suffered through the bank's failure. After the crisis of 1924, the licensing system was extended to banking firms not organized as joint-stock companies and existing firms of the kind had their claims to be allowed to carry on banking business severely scrutinized. As a consequence many did not apply for the license and went out of business.

SAVINGS BANKS

Savings banks have been in existence in Austria for over one hundred years, the first institution of the kind having been the

Erste Oesterreichische Sparkasse in Vienna, established in 1819. The first savings banks were free associations of small investors founded by philanthropists with the object of " combating poverty " by enabling the lower classes to invest their small savings securely and to augment them through the accumulation of interest. The success attending these institutions induced the Government to issue a decree on September 22, 1844, which laid down the guiding lines for the organization of savings banks (Sparkassen-Regulativ) and under which municipal corporations were also encouraged to establish savings banks. In order to protect depositors against losses, a far-reaching government supervision was instituted and the investments permitted to savings banks were narrowly circumscribed, the principal investments being loans on mortgage security, State bonds and municipal corporation loans.

Organization. Savings banks organized as joint-stock or limited liability companies are not permitted in Austria.[10] The usual form they take is therefore that of an institute which is either founded by (and under the responsibility of) a public administrative corporation (city, township or rural district) or by a private association of individuals. The former kind of savings bank is by far more numerous in Austria. In either case an initial capital (Gründungs-Fonds) is supplied by the founder (the public corporation) or by the founders (the members of the association) which is not repayable until a reserve fund to be accumulated reached a certain percentage of the savings deposits. In the latter stages of the savings bank's career the reserve fund alone therefore takes the place of the capital account of other undertakings. The management of a savings bank is under the supervision of an executive committee (Sparkassen-Ausschuss), membership of which is a purely honorary function with a view to keeping overhead expenses low. The savings banks are also forbidden under the " Sparkassen-Regulativ " to loan funds to the members of their committees. The net profit is used to

[10] They are permitted under the Hungarian law, however, and when a small district of Hungary was transferred to Austrian sovereignty under the provisions of the treaties of St. Germain and Trianon, being constituted as an Austrian federal province under the name of Burgenland, the savings banks already in existence there, which were organized as joint-stock companies, were tacitly permitted to carry on their business.

strengthen the reserves, and only when the latter have reached a certain amount may any further surplus be employed, with the sanction of the authorities, for public welfare purposes. These legal provisions have offered an effective guarantee for the security of deposits, which is enhanced in the case of communal savings banks, by the liability of the respective city, township or district.

Position Prior to the Currency Stabilization. In 1913 the number of savings banks on the territory of the present Austrian Republic was 199 with deposits totalling 2,963,000,000 gold kronen, equivalent to about $592,600,000. Of this amount about 60 per cent were invested in loans on mortgage security, 22 per cent in bonds, 7 per cent in municipal loans and 5 per cent in bank deposits.

Enlargement of Activities of Savings Banks. The outcome of the war led to considerable changes in the nature of transactions engaged in by the savings banks. Their holdings of War Loan stock and of other securities became depreciated and the savings banks thereby lost the larger part of their reserves. Loans on mortgage security previously granted by them were repaid to the savings banks in depreciated currency, while the amount of savings deposits, expressed in terms of gold, dwindled to an infinitesimal fraction. On June 30, 1922 it was 6,000,000 gold kronen, i.e., 0.2% of deposits held in 1913. The savings banks therefore strove for an enlargement of the sphere of transactions permitted to them and finally obtained the Government's sanction thereto (June 22, 1922). This enabled them to grant credits to their clients on current account, to develop their discount business and to carry out stock market and foreign exchange orders for account of their customers. Authority for the enlargement of the sphere of business was not granted generally, but for each savings bank individually on application and after a thorough examination of the merits of each case.

The granting of authority to engage to a certain extent in business which had been reserved to the commercial banks met, of course, with opposition on the part of the latter which, in some respects, was justified, as the banking business requires an expert knowledge, which cannot always be expected of the members of a Sparkassen-Ausschuss. On the other hand, it may be the

case that through the extension of the sphere of business, one economically useful purpose at least has been served in so far as small tradespeople, for whom it is difficult to obtain a credit from a commercial bank, can obtain accommodation through savings banks, which through their knowledge of local conditions should be able to grant it at little risk and with a comparatively small organization.

Present Situation. Since the stabilization of the Austrian currency savings deposits in all institutions which engage in this business have risen rapidly and their total amount was S 1,128,-000,000 at the end of March, 1928. This figure includes deposits in savings banks proper as well as those in other financial institutions. Loans on mortgage securities have also been again granted, though their extent, owing to the rent restriction in force in Austria, is far smaller, even proportionally, than before the war. There are, however, some savings banks which, according to their balance sheets for 1926, have invested over 50 per cent of their deposits in loans on mortgage securities and a large portion of these loans is given for house repair purposes. Under the Rent Restriction Act, owners of houses which were already in use when the Act came into force, can obtain no yield from the capital invested in such houses beyond a purely nominal rent payable by the lessees. The cost of keeping the house in good repair, or of undertaking indispensable improvements, cannot therefore be defrayed by the owner, since he obtains no revenue from his property, but these expenses are payable by the lessees in monthly instalments, generally spread over a number of years, including interest. The money required for such repair work is frequently advanced to the house owner on hypothecary security by a savings bank. The usual duration of repair credits is five years, but longer or shorter terms also occur. This sort of business has in recent years obtained a certain importance. It is also remarkable that, while in the pre-war time about 5 per cent of the aggregate deposits only were invested by the savings banks in credit balances with commercial banks, the percentage is now between 22 and 25. This is due to the change in the character of savings deposits, which are now more mobile than they were before the war, though they do not now fluctuate as they did in the inflation period.

Of the savings banks in existence 46 belong to associations, and 153 to municipal corporations, and to smaller communal or rural administrative districts. In addition thereto, there are two savings banks owned and guaranteed as to the security of deposits by the State, namely the Post Office Savings Bank, whose rôle has already been discussed in these pages, and the Dorotheum. The latter is a pawn office and auctioneering institution which obtains the funds required in these branches of business through the acceptance of savings deposits. For a short time ordinary banking business was also engaged in, but rumors of losses suffered by the banking department of the Dorotheum led to a run on its pay offices in the early part of 1927. With the temporary aid of the large banks all demands could be satisfied, though the Dorotheum has lost a considerable number of its depositors.

The savings deposit business, as has been observed in the section dealing with the commercial banks, is not limited to savings banks proper. In addition to these and to the commercial banks the Provincial Mortgage Institutes and the Coöperative Credit Associations engage in this business also, though on a far smaller scale. The following survey shows the distribution of savings deposits among the various types of financial institutions (with the exception of Credit Associations whose statistics are still incomplete), as well as the development in the period from January, 1923 to March, 1928.

Savings Deposits
(in schillings, 000's omitted)

	January 1923	*March 1928*
Vienna Savings Banks	4,889	391,429
Vienna Commercial Banks	7,496	515,506
Provincial Savings Banks	3,293	160,490
Dorotheum		29,538
Provincial Mortgage Institute of Lower Austria		25,222
Vienna Coöperative Society		6,092
	15,678	1,128,277

THE PROVINCIAL MORTGAGE INSTITUTIONS

(Landes-Hypotheken-Anstalten)

The Landes-Hypotheken-Anstalten are public mortgage banks founded by, and under the supervision of, the Government and Diet of the Federal province where they have their seat, the provinces being also guarantors of all liabilities of these institutes. There is one Landes-Hypotheken-Anstalt in every province.

The sphere of activity of the Landes-Hypotheken-Anstalten comprises the granting of hypothecary credits and of communal loans within the boundary of the respective province, the issue of mortgage and of communal bonds, as well as the savings deposit business. The Landes-Hypotheken-Anstalten aim at no pecuniary gain and in view of their public character the end they pursue is the benefit of the community. They are therefore extending credits chiefly to the owners of small and medium size agricultural holdings, the owners of big estates being generally able to obtain credit elsewhere, if required. This entails a large amount of work, which is barely remunerative, but which leads to a distribution of the risk over a wide field. The risk is further reduced through a provision in the statutes of these mortgage banks that loans may be granted only to enterprises within the boundary of the province, a provision which enables a close observation of the movement of commodity and real-estate prices.

Loans to Administrative Corporations. The provincial mortgage institutes have separate departments (which in some cases, though they are under the same management as the mortgage institute, take the shape of an independent bank) for the extension of credit to administrative corporations. Loans may be granted to such corporations only as have the right to levy imposts on their constituents. The loan must be for productive purposes and approved of by the Provincial Government which first satisfies itself that provision for interest and redemption has been made in the budget of the respective corporation. In case of default the Provincial Government will step in and levy special contributions on the constituents of the corporation for the purpose of meeting these charges.

Granting of Short-Term Loans. Long, as well as short-term loans (to individuals and to corporations) are granted. In the latter case (short-term loans) the required funds are obtained from savings deposits, while long-term loans are financed through the issue of mortgage bonds. In the case of some such issues payment in gold is promised to the holders of bonds. In the countervailing transactions, where the provincial mortgage institute advances funds on hypothecary security, the borrower must also engage, of course, to pay on a gold basis. The provision is practically without importance in view of the stability of the Austrian currency, but it was inserted in some issues in 1925 when it was intended to interest foreign capital in this class of securities.

CREDIT ASSOCIATIONS FOR TRADESPEOPLE

The Credit Associations are coöperative societies whose object is to extend the facilities of banking to circles which otherwise would be denied these advantages. The idea underlying these organizations is that, while the individual tradesman, small dealer or employee may not offer sufficient guarantee for credit being given to him, an organization of such people, where all members would be jointly and severally responsible for the liabilities of the association would be a fit object for credit transactions.

Shares of Coöperative Credit Associations. The initial capital of coöperative credit associations consists of the shares (Geschäftsanteile) of members which, like the shares of joint-stock companies, are in round sums of a fixed nominal value. The credit basis of coöperative associations, however, is not limited by the amount of this capital, as it is in the case of joint-stock companies, but it extends further, comprising the personal credit of the members, who are liable beyond the amount of the share they have in the association and generally to the extent of a multiple of that share. Under these conditions it is of great importance to would-be creditors of the association to know who are its individual members and the law therefore provides for a publicly accessible register to be kept by the association where all members are entered with the dates on which they joined or left the association. The capital (Geschäftseinlagen-Kapital) of co-

operative credit associations is not definite and fixed, as it is in the case of joint-stock companies, but may be increased or decreased by new members joining or old members leaving. The responsibility of a member leaving the association, however, ceases only after the expiration of twelve months from the end of the year in which he left the association. Every member, irrespective of the number of his shares, has only one vote. Another feature which distinguishes coöperative societies from enterprises organized on a capitalistic basis, is the identity of the association (i.e. the members of the association) with its clients. No member of a coöperative association has, of course, a right to obtain credit purely on the strength of his membership, but his application will be granted within the limit of the available means, provided the conditions upon which the executive committee make the granting of the credit dependent, are complied with in his case. These conditions are imposed in the interest of the association as a whole and comprise the security of the credit, its use for productive economic purposes and its proportion to the extent of the enterprise.

Associations Among Credit Associations. The urban credit associations are organized in " Anwaltschafts- und Revisions-Verbänden " (attorneyship and audit unions) which offer legal advice to their members and audit their accounts. One audit every two years is compulsory under the law, but recently an audit taking place once a year has been voluntarily introduced. The Oesterreichische Zentral-Genossenschaftskasse, which has been in existence since 1922, of which the majority of these credit associations are members, acts as a central bank and clearing office for them.

Statistics of the Coöperative Societies. The statistics of Coöperative Societies are incomplete. The provisions of the Gold Balance-sheet Act became effective for them in 1926 only and many relevant figures are still lacking concerning a considerable number of these associations. Their total number exceeded 500 in 1928. At a convention of the credit associations held in May, 1928, 260 societies reported, whose balance-sheet totals were S 158,422,650. Their aggregate capital amounted to S 7,760,808 and reserves to S 6,492,656, while savings deposits under their administration were stated to be S 134,891,838 and outstanding

loans to members S 125,660,667. A comparison made in the case of 30 medium-sized societies between their pre-war position and the existing conditions shows that capital and reserves, savings deposits and outstanding loans now amount to about one-third of the respective items in the balance-sheets of 1914. It must be taken into consideration that the currency inflation had wiped out completely all capital invested in titles to money and that these figures do not so much represent an advance on existing lines as a creation *ab ovo.*

AGRICULTURAL CREDIT ASSOCIATIONS

The chief feature which distinguishes the agricultural credit associations from the credit associations for tradespeople is that membership in the former organization entails an *unlimited* responsibility for all liabilities of the association as opposed to the liabilities of the members of urban credit associations, which is usually limited to a variously fixed multiple of the shares (Geschäftsanteile) possessed by each member. Only rural landholders are eligible as members of the agricultural coöperative credit societies (also called Raiffeisenkassen after the German founder of the institution). There are at present about 1,700 Raiffeisenkassen in Austria. Members requiring loans must offer a reasonable security or the guarantee of one or two other farmers. The activity of every Raiffeisenkasse is limited on principle to the district where it has its seat.

"Raiffeisenkassen." Short-term loans only are granted, but in view of the requirements of agriculture the duration of a credit is at least nine months, because the capital invested in agriculture is turned over once a year only. The Raiffeisenkassen obtain the necessary funds from deposits of their members and of other inhabitants of their district. The fact that members are liable to the full value of their estates for all liabilities of the association offers considerable attraction to small rural investors.

Coöperation Among the Agricultural Credit Associations. In regard to their internal organization the Raiffeisenkassen resemble closely the urban credit associations described in the previous sections, and with the exception of the responsibility of

members (which is *unlimited,* in regard to Raiffeisenkassen and, as a rule, limited in the case of urban credit associations) the legal provisions governing both kinds of institutions are the same. In every province the Raiffeisenkassen are united in one "Landwirtschaftliche Genossenschafts-Zentralkasse" (Central Office of Agricultural Coöperative Societies) which within the federal province acts as a sort of central bank for the societies. Surplus funds available are placed with farmers' coöperative productive societies, where possible, or else another remunerative investment has to be found for them. In recent years the investment of sums in other than agricultural enterprises has been proportionately larger than it was before the war. As a matter of fact, all central offices have funds at their disposal which they find it difficult to employ remuneratively in agricultural loans. This is due to the fact that the rates of interest for such loans, depending of course, upon the official bank rate, are still higher than the average yield of rural holdings.

THE "GENOSSENSCHAFTS-ZENTRALKASSE" OF LOWER AUSTRIA. The Genossenschafts-Zentralkasse of Lower Austria is the largest provincial central office of agricultural coöperative credit associations in the country and accounts for about one-third to one-half of the total money turnover effected by all provincial central offices combined. In 1913 this Genossenschafts-Zentralkasse had a turnover of 87 million gold kronen, equivalent to 130 million schillings. In 1925 the turnover amounted to 19.3 million schillings only. In 1913 the aggregate of deposits of member associations was 65.5 million schillings, while it figured at 18.6 only in 1925. Outstanding loans were 12 million schillings in 1913 and only 6.6 million in 1925.

It deserves to be mentioned that, while the Agricultural Credit Associations have been provincially organized as members of the Genossenschafts-Zentralkassen for some time, no common organization uniting the provincial central offices in one national central office was in existence until recently. In August, 1927 a central clearing institute was formed for that purpose by the provincial organizations of coöperative credit organizations in conjunction with the Allgemeine Oesterreichische Boden-Credit-Anstalt and with the participation of the Preussische Zentral-Genossenschaftskassa, Berlin. The Institute which was organized as a joint-stock

company under the style of Girozentrale der Oesterreichischen Genossenschaften has a share capital of S 5,000,000, three-fifths of which were subscribed by the provincial organizations of credit societies and by the Allgemeine Oesterreichische Boden-Credit-Anstalt jointly and the remaining two-fifths by the Preussische Zentral-Genossenschaftskassa. With a view to ensuring a preponderating influence to the coöperative societies, it has been provided that the President of the Girozentrale and at least one-half of the Board of directors must be chosen from among the members of the local organizations of credit societies.

CONCLUSIONS

After this discussion of the history and present organization of the Austrian financial system a word requires to be said on the changes which have taken place in the last ten or fifteen years, i.e., in a period which, in Austria as well as in most other countries, has been contemporary with a political, economic and social evolution, which was hardly, if at all, suspected in the first decade of this century. That a development of such importance should have left its traces on the banking organization of Austria is natural, especially when the fact is borne in mind that of all Central European countries Austria has perhaps been most affected by the rearrangement which took place during and after the war. If an attempt is made to inquire into the exact nature of the changes wrought by international and national commotions during that period, and if one endeavors to ascertain the extent to which outside forces have been allowed unhampered play in modifying the Austrian financial organization, it is found that, apart from the temporary modification produced by the destruction of normal exchanges during the hostilities and for some time after their cessation, and by the somewhat unbalanced feeling which prevailed during the inflation period, no deep changes have been effected in the system.

Relative Importance of Banks in Economic Life of Austria. The financial institutions have certainly suffered a diminution of their capital and the volume of business has been considerably reduced as compared with the pre-war period. But

their relative importance, as factors in the economic life of Austria, has not only remained unimpaired, but has actually grown. This is due to the continued prevalence of the conditions, which primarily led to the acquisition of a preponderating influence by the Austrian banks over the industrial and commercial life of the country in the last quarter of the 19th century. During a period as critical as the one under review industry and commerce had to lean to a larger extent on the banks, whose hold on them thus became still firmer.

The question whether this control constitutes an advantage or a disadvantage to national economy has been often debated, not so much in Austria as among foreign students of banking, but a perfectly conclusive answer thereto has been returned by the two prominent experts, Messrs. Charles Rist and W. T. Layton, who conducted an inquiry into the conditions of Austria in the summer of 1925:

" The scarcity of capital and of small savings which made industrial investment impossible explains the important part played by the banks in the industrial life of Austria. Savings did not readily find their way, even into the banks, and Austrian credit institutes had to grant a rate of interest of four per cent at a time when the customary savings bank rate elsewhere — as for example in France and Great Britain — was 2½ per cent. In these circumstances it was quite natural that Austrian industry should have been fostered by national financial institutions and, through their agency, by international capital. *It is therefore irrelevant to ask whether the participation of banks in industry has been beneficial to its development and technical improvement, or the reverse. Where there is only one solution it is necessarily the best.*"

Foreign Investments in Austrian Banks. The Austrian banks were quick after the war to reëstablish the relations which, prior to 1914, had united Vienna with the large financial centers of the world. The traditions of the Vienna credit institutions and the manner in which they acquitted themselves, under peculiarly difficult conditions, of their pre-war obligations towards ex-enemy countries, inspired confidence abroad and materially assisted in re-linking Austria again to international finance. Foreign capital is now invested in all the more important commer-

cial banks of the country to a considerable degree and some of the leading foreign financial houses (especially American) are represented on the board of Vienna credit institutions and, incidentally, on the boards of industrial companies belonging to the " Konzern " (i.e., the sphere of influence) of the banks. While this was in some degree the case already before the war, the relative extent of the interest possessed by foreign groups is now much larger.

Position of Vienna Banks in Successor States. The position which the Vienna banks occupy in the economic life of the Successor States is a delicate point to discuss. Owing to the endeavors of the Succession States to free themselves of the economic influence of Vienna, the Austrian banks have lost ground here and there, while in other places they were able to maintain and even extend their hold. Though it is perhaps not questionable to which side the balance inclines, the banks have given a creditable account of themselves in this respect and have also rendered conspicuous services to the national economy of those states. The Vienna banks also continue to hold a considerable influence in various credit institutions of the Succession States, and through them, in a large number of financial and industrial enterprises. Any change of the situation which has arisen, compared with the one existing before the war, has therefore been a modification in degree rather than in essence.

Concentration Movement. A feature of the period under review which to students, in countries where the effects of currency depreciation have not been felt, might appear striking, is the fluctuation of the number of banks, but the causes which led to a large increase of banking establishments in the time of the currency inflation are explained through the peculiar conditions which then obtained and the mentality which they engendered. The subject has been dealt with at some length in previous sections and its details need not therefore be recounted here. These peculiar conditions, as well as the banks which came into existence in the inflation period, were a passing experience. When they had disappeared, along with some old establishments which had been unable to steer through the crisis of 1924, the remaining banks, with no likelihood in the near future of a stock-exchange and issuing business on the scale witnessed during the inflation, were faced with the problem of suiting their organization to the

existing conditions. This meant retrenchments through the dismissal of a considerable number of clerks (at substantial expenses to the banks, owing to the necessity of paying compensations) and further brought the topic of "concentration" to the foreground. The word, as it is understood in Austria in this connection, implies the gradual amalgamation of smaller institutes by the large banks. This policy began to take shape in the first half of 1926 with the absorption of the Austrian establishment of the Anglo-Austrian Bank by the Oesterreichische Credit-Anstalt. Further steps on the same road were the absorption of a number of provincial institutions by the Oesterreichische Boden-Credit-Anstalt and, finally, the amalgamation through the latter bank of the Verkehrsbank and Union-Bank in Vienna. The full effect on the remunerativeness of the banking business which these sundry mergers have had, will become apparent in 1928 only, when a complete financial year will have elapsed since the more important of these transactions have taken place. The amalgamation has already had the effect of considerably increasing the turnover of the remaining banks.

At the beginning of 1927 the Austrian banking organization would appear to have completed its adaptation to the existing conditions, though the tendency continues to be towards further retrenchments and greater economy in working expenses. The ulterior development will depend on the degree of economic prosperity in Austria. Symptoms interpreted with the greatest care by economic experts would lead to the conclusion that the country is gradually emerging out of the stagnation which followed the crisis of 1924. It should be remembered, however, that in a small country like Austria the rate of economic progress is largely determined by circumstances or forces which originate outside the frontiers of the state.

CHAPTER IV

THE BANKING SYSTEM OF BELGIUM

BY

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HISTORICAL SUMMARY OF THE MONETARY SYSTEM

THE DUTCH PERIOD. After having had an extremely disturbed political and economic history as a result of her geographical position between powerful and hostile neighbors, Belgium, under the Convention and Napoleon I, was annexed to France, whose armies had conquered the Netherlands (Belgium and Holland). In 1815, after the fall of the Empire, Holland, under King William of Orange-Nassau, regained its independence and, by the Treaty of Vienna, Belgium was joined to her " as extension of territory." Religious and political differences divided the inhabitants of the two parts of the kingdom, which, however, from the economic view, supplemented one another admirably. Holland had her own bank of issue which, on the union of the two countries, naturally was to serve the Southern as well as the Northern provinces.

The Belgian metal currency, on account of the long occupation of the territory by the French armies and civil administration, was overburdened with French coins, principally silver, and the Dutch florin, the legal coin, was introduced only with difficulty. Notes of the Bank of Amsterdam did not circulate since local customs were unfavorable to the use of fiduciary money that was payable in florins, a unit little used in the South. To remedy this situation, which was of the greatest harm to the country, King William created in 1822, at Brussels, the capital of the Southern provinces, a bank of issue called " Société Générale pour favoriser l'industrie nationale " (General Society for the Promotion of National Industry), or simply, " Société Générale," with

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a capital of fifty million florins (twenty million of which were in crown lands) represented by shares of five hundred florins.

Powers of the Bank. The powers of the new bank were very complex. It could receive deposits, issue notes and bonds. The last could not exceed twenty million florins; the amount of the notes " should always be calculated according to the total and real capital of the Société. No arrangement was provided for the metallic reserve." The bank could discount, make advances on securities, or commercial paper, on merchandise, on real estate, etc. It was fiscal agent to the State. " The program of the Société Générale was far from meeting the demands of a rational banking policy, as we conceive it at present. But, at that time, the principle demanding the separation of the issue of notes from other operations was scarcely beginning to evolve. Likewise, the conferring of a landed endowment on a bank for commercial and industrial credit seemed a happy measure. The principal form of wealth consisting of real estate, such an endowment would constitute an element of prestige and power." Let us add that there were in Belgium at that time only private bankers, the most important of whom operated in Antwerp. In 1824, in Brussels, " twelve intermediaries were sufficient for all the transactions of the Stock Exchange, not only in public securities, but also in merchandise, insurance, etc." Quotations of securities, in both Brussels and Antwerp were established only twice a week.

The Société Générale established, in a small way to be sure, the circulation of fiduciary money in Belgium and also instituted industrial credit.

Independent Belgium — Plurality of Banks of Issue. The revolution of 1830 divided into two parts the Kingdom of the Netherlands. The Société Générale, by reason of serving as fiscal agent of the Dutch Government up to the revolution, had numerous difficulties with the Belgian Government, but it preserved that function under the new régime as under the old. In 1833, to counterbalance its power, there was created by royal decree on March 4, the Bank of Belgium, which, like the Société Générale, had very extensive powers and the right of issuing notes to the amount of its capital, that is, to twenty million francs.

The Banque Liégeoise was established at Liége the same year, with the right of issue to the amount of three quarters of its capi-

tal of four million francs. It could receive deposits, organize a savings bank, and make mortgage loans. "The charter forbade it expressly to grant discounts — a strange provision for a bank issuing notes."

On August 13, 1841, the Bank of Flanders was established, with English funds, with a capital of ten million francs. It also was given the right of issue and was to handle short-term credit in Flanders.

These four banks, assisted by private bankers of which some firms survive nowadays, continued to exist as banks of issue until 1850, the year of the creation of a sole institution of issue, the National Bank of Belgium. They passed through several crises, notably in 1848, a time when the government had to decree forced legal tender, not on account of an excessive circulation of bank notes, but because the bank of issue, engaged in industrial operations, had fixed assets that could not be realized. The table below gives the fiduciary circulation in Belgium during the crisis, the two large banks in Brussels alone continuing to issue notes.

	Société Générale	*Bank of Belgium*	*Total*
	(in millions of francs)		
April 10, 1848.......	15.3	4.4	19.7
June 30, 1848........	28.2	5.8	34.0
December 31, 1848..	32.0	10.3	42.3
March 31, 1849.....	33.6	10.4	44.0
October 15, 1949....	44.7	10.1	54.8
December 31, 1849..	36.4	10.6	47.0
December 31, 1850..	31.7	10.6	42.3

Before 1848, the total note issue, including that of the private bankers, fluctuated around twenty million francs, against a supply of two hundred million francs of gold and silver coins in circulation. Until the foundation of the National Bank of Belgium, sole bank of issue and fiscal agent for the State, commercial credit, properly speaking, was very little developed. Resort to discount was not only limited but badly distributed. The Belgian public grew accustomed but slowly to the use of bank notes, known only in the large centers. The banks of issue were rent by powerful economic and political rivalries. They neglected the business of discounting to finance the formation of corporations and, on account of the lack of a central bank, each bank, in case of crisis,

could depend only on itself. In a country with so limited a territory as Belgium, the plurality of banks of issue had the unexpected consequence of restricting the circulation of bank notes to such an extent that only the forced legal tender decree of 1848 rendered them better known to the population.

Financing Companies. We have seen that the banks of issue in Belgium played really the rôle of "promoters." This fact is worth dwelling on, for it is in Belgium, and not in Germany or France, that we find the historical origin of the "mixed banks," so characteristic of the banking organization of the European continent.

The creation of corporations — numerous for the period and for the state of the country's industrial development — was largely the work of the two banks of issue in Brussels, which did not always intervene directly, but entrusted the task of putting their projects into execution to "subsidiary companies which they had founded, associations closely related to what are now called in Belgium financial trusts or investment banks. The introduction of this type of company is often attributed to the English, who began to establish them about 1860. However, as a matter of fact, these two types were functioning in Belgium as early as 1835." (Chlepner.) According to their own statutes, the kind of activity of two of these investment companies is: "to contribute to the formation of all useful enterprises by taking an interest in them; to buy and sell merchandise, concessions, annuities, and other securities; the investments that the company shall make shall be regulated constantly so that its capital may be divided among the greatest possible number of establishments and always in proportion to the capital of the company."

Characteristics of the Period. The preceding discussion can be summed up as follows: From 1830 to 1850, Belgium had a plurality of banks of issue, which, far from leading to excessive issues, did not render the use of the bank note popular. The circulation of bank notes spread, thanks to the forced legal tender, established to remedy the want of liquidity in the banks' assets, and not as the consequence of any inflation. The banks of issue had various activities; they carried on a mixture of operations, contrary to present sound monetary principles. Commercial credit was undeveloped. On the other hand, industrial expansion

necessitated the concentration of capital for the establishment of companies. A certain specialization was necessary for the handling of the launching of these enterprises, hence the origin of financing companies, closely related to the mixed banks. These two types of bank originated in Belgium.

THE LATIN UNION. MONETARY TROUBLES IN BELGIUM

The monetary history of Belgium is closely bound to that of the Latin Union. The metal circulation was largely composed of foreign coins, as a result of the Kingdom's having passed many centuries under different masters and in less than fifty years, having known in turn Austrian, French and Dutch domination.

The monetary law of June 5, 1832, made Belgium in this respect a satellite of France. "By that law," writes Professor Willis, "she adopted in its entirety the monetary system of France and even went so far as to give to the French silver five franc pieces, the quality of legal tender in Belgium. The essential stipulations of the law were briefly these:

1. Five grams of silver nine-tenths fine constituted the monetary unit which was called the franc;
2. The subsidiary coins, also nine-tenths fine, were to be the same as those of France;
3. The national gold coin was to be the 20 franc piece and one kilogram of gold was to be coined into 155 of the pieces."

The original plan presented by the government gave the monetary unit the name of "Belgian pound"; however, on a motion of the central section of the Chamber, the word "franc" was adopted, creating a situation that began to be modified at the end of 1926 only.

As a matter of fact, from 1832 to 1847, the gold coinage was nil, and that of the five franc silver pieces did reach ten millions. At the same time, the gold florins of the Netherlands, struck with a higher coinage ratio to silver than the French par, were abundant in Belgium where they were still legal tender.

"To recapitulate, the various coins legally recognized were these:

1. Belgian silver coins.
2. Belgian gold pieces of 20 and 40 francs.
3. Dutch gold 10 florin pieces.
4. French gold pieces of 20 and 40 francs."

But the need of a national coinage was becoming felt and opinion was becoming disturbed over a " monetary parasitism " that placed Belgium between countries with a gold standard and others with a silver standard, exposing her to constant drains.

On March 31, 1847, a new law was passed, providing for:

1. Suppression of Belgian coins of 20 and 40 francs, the rate of issue of which was 3,444.44 francs per kg. fine;

2. Manufacture of 10 and 25 franc pieces at the rate of 3,495 francs per kg. fine. This system was greatly criticized. In fact Professor Willis characterized it as follows: " The legislation seems to have been of a very haphazard character."

Effect of the Revolution of 1848. The revolution of 1848 in France and the premium on gold in Paris and Amsterdam led to the repatriation of French and Dutch coins. To remedy this, a new law, passed March 3, 1848, made the English sovereigns forced legal tender at the rate of 25.50 francs.

" At this time then," writes Professor Janssen, " there could circulate simultaneously in Belgium as legal tender four sorts of gold coins, manufactured under different conditions in four different countries:

	The kilo	*Ratio between gold and silver*
The French gold franc was calculated in francs	3,444.44	15.50
The English sovereign was calculated in francs	3,485.64	15.67
The Belgian gold franc was calculated in francs	3,495.—	15.80
The 10 florin piece of the Netherlands was calculated in francs	3,500.—	15.87

Scarcely were these measures taken when gold began to decrease in value, and the Minister of Finance, Frère-Orban, submitted a bill proposing the demonetization of French gold and the progressive withdrawal of the Belgian gold coins. The passage of this law would lead to the rupture of the *de facto* Franco-Belgian monetary community, and would substitute for bimetal-

lism the single silver standard. But the government made the mistake of not baptizing the Belgian coin with a new name, and French gold, although legally prohibited, gained ground.

GRESHAM'S LAW IN OPERATION. These French gold coins, readily accepted by the populace, were substituted for silver coins exported for remelting. At the same time, worn French silver pieces invaded Belgian circulation. "As much of the French silver coin had lost fully 6% of its value by wear, it was a very profitable operation to export this light-weight coin to Belgium, where it was still legal tender, exchange it for heavy Belgian coin, melt the latter, and re-export it to Holland and Germany, the two principal countries of the single silver standard. In this way, the better part of the silver circulation of Belgium was gradually exchanged for the abraded French coin."

For the third time, June 4, 1861, the Belgian Chamber modified the monetary system by again adopting the double standard of gold and silver (ratio 1—15½) as it existed in France.

THE ALTERNATING STANDARD. This was to introduce in reality not a double standard but an "alternating" standard, occasioning constant changes in the discount rate and the progressive deterioration of specie. "Surrounded as she was by countries some of which had the single gold and some a single silver standard, while the actual currencies frequently corresponded to neither, Belgium was in a position to feel most keenly the disastrous consequences of her alternating standard."

Under the double influence of the outflow of gold and the exportation of silver into France, Belgium, Switzerland and Italy, whose different laws established a *de facto* monetary union, the five franc silver pieces disappeared from these four different countries and were followed in their exodus by the fractional coins. Thus the intrinsic value of the subsidiary coins was sensibly lowered in the different countries by the laws of circumstances. Belgium, alone having preserved her fractional coins at a standard of 900/1000, saw them disappear and circulate abroad without being able to benefit by a reciprocal situation.

MONETARY CONVENTION OF 1865. It was Belgium who took the initiative in an international conference that resulted in the first formal convention of the monetary union called the Latin Union (December 23, 1865).

The convention was composed of Belgium, France, Italy and Switzerland, united in regard to the weight, standard, diameter and legal tender value of their gold and silver coined specie, copper coins excepted. The five-franc silver pieces and the gold pieces had a standard of 900/1000 and the fractional coins a standard of 835/1000.

The silver pieces were made legal tender between individuals of the issuing state to the amount of fifty francs per payment. The public treasuries of each of the contracting parties received the silver coins of the other signing states to the amount of one hundred francs a payment, each of the governments being pledged to accept from individuals and the public treasuries of the other states the subsidiary coins that it had issued and to exchange them for an equal value of current coin, on condition that the sum presented be equal or superior to one hundred francs. The obligation of acceptance and exchange was to remain valid for two years after the expiration of the convention.

The quantity of fractional silver coins was limited to six francs per inhabitant, that is, 32,000,000 francs for Belgium.

The convention was to remain in force for fifteen years, until January 1, 1880, then, unless it were protested, it was to be renewed by tacit continuation for further periods of fifteen years.

No mention can be made here of the arrangements affecting the other countries; the excellent works of Professors H. Parker Willis and Albert E. Janssen will permit the reader to inform himself fully on this subject.

Belgian Proposals Defeated. It is fitting to remark that the bimetallic system was maintained although the Belgian delegates had been instructed to favor the adoption of the gold standard. Belgium, the battlefield of Europe and the junction of civilizations and monetary systems, had dearly learned to fear the consequences of the double standard. But against the will of the Swiss, Belgian and Italian delegates, the French Government exacted the maintenance of bimetallism, which permitted the Bank of France to pursue an easy policy of protecting its reserve.

Adoption of Gold Standard by Germany. From 1850 to 1865 silver was at a premium compared with gold. After 1866 gold began to be at an increasing premium relative to silver, and speculation commenced again, but in a different manner. The

German Empire in 1871 had adopted the gold standard, which led to the demonetization of the German silver coins. "If the free minting of silver, in the ratio of 1 to 15½, was maintained in the states of the Latin Union, it is certain that the great mass of German silver, estimated at a billion, would be melted in the crucibles of the mints of the Union, to come out in the form of five franc pieces."

This threatening situation alarmed the Chamber of Representatives of Belgium, and the former Minister of Finance, Frère-Orban, advised the government to call a conference to decide on the limitation or suspension of the coinage of silver. The summons led to no result. But the manufacture of silver pieces at the Brussels Mint increased considerably and the consequences of an excessive coinage became evident, especially since speculators were preparing to present for minting large quantities of Austrian florins, demonetized in Germany.

Limitation of Silver Coinage. On September 5, 1873, the Ministry limited the coinage of five-franc silver pieces to 150,000 francs a day. The National Bank of Belgium had proposed the suspension pure and simple of the coinage of silver pieces, the single adoption of the gold standard and the revision of the convention of the Latin Union. By royal decree, December 18, 1873, the exchange office was closed to private individuals in regard to silver, and the coinage of silver pieces took place exclusively for the account and profit of the State. The other signing states took analogous measures.

Modification of Convention. On January 31, 1874, a supplemental agreement to the convention of the Latin Union procured the first limitation of silver coinage. For the year 1874 Belgium was allowed to mint only 12,000,000 francs in five franc silver pieces, 5,900,000 of which were for ingot receipts delivered before December 31, 1873. This restriction was prolonged for the year 1875. In 1876, the Belgian quota was reduced to 10,800,000 francs. Belgium, which had minted 111 millions in 1873, thus accepted a serious limitation, more severe than that of any other country.

The convention therefore was profoundly modified, and as it would expire December 31, 1879, the French Government, to prevent its tacit continuation, denounced it in 1878. A new con-

ference was assembled. "Belgium asked in substance for the absolute suppression of silver coinage in the five states; she declared she was ready to accept as legal tender the gold pieces of the Union and opposed to giving legal tender character to the silver pieces, and she showed little eagerness to conclude an agreement of fixed duration, in order to be able to procure the means of passing over to the single gold standard when it suited her."

As Italy, following the war of 1866, had a system of forced legal tender paper money, Belgium and France asked for guarantees from Italy for the future; "the States called attention to the fact that on the expiration of the treaty, Italy might have an increased forced legal tender, or wish to pass over to a silver standard by substituting for paper, notes printed on silver metal. In either case, it was certain that Italy would leave the Union and that the Italian coins circulating in the other States would suffer depreciation." France and Belgium did not wish to undergo the loss resulting from this, and asked that Italy take back her coins circulating in the other States and replace the equivalent of the amount with gold.

The convention of 1865 was renewed with modifications; the coinage of five-franc silver pieces was temporarily suspended and could be resumed only on the unanimous agreement of the contracting States; the issue of fractional coins could not exceed six francs per inhabitant, that is, 33,000,000 francs for Belgium, including the quantities already issued. The National Bank of Belgium, like the Bank of France, was pledged, by an added clause, to accept at its counters the coins of all the States of the Union. By the terms of Article 15 of the convention of November 5, 1878, the latter should remain in force until January 1, 1886, and, unless denounced, be prolonged from year to year by tacit continuation. The negotiations that took place in 1885 turned on the insertion of a "clause of liquidation" in view of the eventual disbanding of the Union.

"France," Professor Janssen writes, "possessed a supply of Belgian and Italian five franc silver coins representing from 700 to 800 million francs at legal value, but which, melted into ingots and valued at the commercial rate for silver in 1885 would have immediately lost 22%, that is from 154 to 176 million francs." France was seeking a way to avoid this loss.

The French delegation proposed that the contracting States should be pledged to redeem, at the nominal rate, the coins issued by each, on the dissolution of the Union.

The Belgian Government opposed this. Such a clause would be particularly onerous for the country that, in proportion to the other States, had minted much more silver than its circulation required, especially since the payment of the French war indemnity to Germany had led to heavy demands for silver in Belgium. Belgium proposed that the contracting parties should simply promise not to demonetize their five-franc silver pieces for a certain number of years after the disbanding of the Latin Union. This pledge would permit the other States to return to Belgium through natural channels the Belgian silver coins still in circulation in their respective territories.

Each maintained its stand; the Belgians left the conference, and the convention of renewal, including the liquidation clause, was signed without them. But official negotiations were soon resumed, and, December 12, 1885, an additional agreement was signed by the contracting States on one hand and Belgium on the other.

In the course of the discussion, Belgium agreed to the return of the national coins through the channels of commerce; France demanded a formal pledge to redeem the coins. According to Professor Janssen, the position of the Belgians was legally unassailable.

By the terms of the additional agreement, the French Government authorized natural liquidation to the amount of one hundred million. This would return to Belgium through commercial channels. The balance, which would not surpass one hundred million, Belgium should pay in gold or gold certificates.

Convention of 1908. Other conventions, not particularly affecting Belgium, were concluded later. In 1908, however, a new convention was signed that has a certain interest for this country. In the meantime, the quota of fractional silver coins of each contracting state had become insufficient. Belgium had exhausted her quota of 46,800,000 francs. It was decided to raise the quantity of fractional silver money to sixteen francs per capita, with the restriction that the annual coinage of each of the contracting States should not surpass 0.60 francs per inhabitant. The mint-

ing could be accomplished by remelting the coins in circulation, the quantity of Belgian five-franc silver coins still existing being estimated at 375,000,000 francs. Belgium requested, in addition, the admission into the Union of her new colony in the Congo, which was destined to absorb considerable quantities of silver in a short time.

On the eve of the war, the Latin Union was maintained, renewed from year to year; the contracting States had a common interest, the liquidation of an important supply of five-franc coins, "the burdening inheritance of bimetallism." The joint interest made it possible to avoid the losses of that liquidation, which would have been particularly felt by Belgium. In fact, the five-franc silver piece had become a sort of unexplorable counter.

Before the war, the dissolution of the Union would have exposed Belgium to the demonetization of the majority of her silver coins, repatriated to maintain the exchange at gold par. This demonetization would have led to contracting an important loan, constituting a heavy budgetary burden. The minting of silver coins for the Congo would permit a part of this supply to be absorbed gradually and would avoid the debt.

The existence of five-franc pieces as legal tender would make it possible for the National Bank of Belgium to protect its gold reserve, the two coins, the silver and the gold, being offered without distinction for the redemption of notes. This gave the National Bank of Belgium the means of maintaining its exchange around par without too frequent resort to raising the discount rate. In fact, since the Belgian silver coin could be presented at the Bank of France, the latter was led to furnish a part of the gold needed by Belgium in her international transactions.

Analysis of Monetary Situation in Belgium. We may have observed in the course of this summary that Belgium was before the war in a rather peculiar monetary situation: bimetallism remained legally in force; however, free coinage, the essential condition of a monetary standard, was suspended, and silver had lost a considerable part of its value. In fact, the Belgian silver pieces were counters that permitted the National Bank of Belgium to preserve its gold and to obtain yellow metal from the Bank of France; the gold of the latter institution sustained the value of the Belgian silver coins.

FORCED LEGAL TENDER IN BELGIUM AND THE DISSOLUTION OF THE LATIN UNION

Without taking into account the one-sided measures adopted by certain countries in special circumstances and which, though in derogation of the pact, were nevertheless tolerated by the other members of the Union, there were no less than fourteen conventions or agreements additional to the first convention of the Latin Union.

The war led to forced legal tender in the different countries of the Union, some adopting it to protect their reserves, threatened by the belligerents in search of precious metal, others as the logical and necessary result of excessive issues, indispensable in financing military operations.

These issues caused monetary depreciation. In the countries at war, the metal coins disappeared from circulation, either being hoarded or attracted to Switzerland, whose exchange had remained at about the metal par. The silver pieces of the Latin Union, still having legal circulation in Switzerland, flowed into that country, especially in 1920, when the price of silver fell greatly. These importations surpassing the requirements of the circulation, Switzerland, contrary to the stipulations of the convention, decreed the five-franc silver pieces of the other Allied countries and the fractional Belgian coins still circulating in the territory of the Union to be no longer legal tender.

Convention of 1921. A convention, December 9, 1921, regulated the situation. The agreement concluded between Switzerland and Belgium greatly reduced the amount of the redemptions. The 6,495,000 francs in Belgian fractional coins in circulation were to be redeemed by Belgium in silver pieces of the Union.

Of the 28,915,000 francs in Belgian five-franc silver coins in Switzerland, 22,915,000 francs were to remain there, the latter country having the right to remelt them and mint Swiss coins from them. The balance of six millions was kept until January 15, 1927, after that date Belgium being pledged to redeem them in equal instalments every three months, the payments being completed within five years at most. In addition, she is to pay an interest of 1% a year until January 15, 1929 and 1½% from

January 15, 1929 to January 15, 1932. Two millions must be paid in gold. In taking into account the interest, but not the expenses of shipment and remelting, the liquidation of Belgium to Switzerland can be estimated in round number at £133,950 sterling.

The amount of Belgian silver pieces in France, according to the calculations of the Belgian financial administration, rose in 1925 to 135 millions, half of which, according to the terms of the additional agreement of the convention of 1885, is redeemable in gold, drafts or French silver coins, the other half through commercial channels. The Bank of France held about 30,500,000 francs in Belgian five-franc silver pieces and 1,000,000 francs in Belgian fractional coins, while the National Bank of Belgium possessed 10,000,000 francs in French five-franc silver pieces and five million francs in French fractional coins. The two banks have exchanged coins to the amount of fifteen millions and Belgium has redeemed the balance in checks on Paris.

As the remelting and hoarding of silver in France has not permitted the collection of the Belgian silver pieces circulating there, the liquidation of the Union between France and Belgium was terminated. Outside of the expenses of repatriation, it cost the loss of the exchange on fifteen millions, but it furnished Belgium with fifteen million francs in silver coins, the intrinsic value of which has largely compensated for that loss. Thus, through the course of events, the liquidation of the Latin Union, which, before the war, appeared disastrous for Belgium, has ended, particularly in regard to France, without any appreciable loss, except to Switzerland.

End of Latin Monetary Union. Therefore, on December 28, 1925, the Belgian Government was able to denounce for the date of January 1, 1927, the convention of 1885, renewed from year to year by tacit continuation.

The monetary confusion reigning since the war in all the countries of the Latin Union, and in those gravitating about it from the point of view of the standard: Spain, Roumania, Bulgaria, and Serbia, renders any new agreement still very distant and problematical. However, the Latin Union, despite its conservatism on the subject of bimetallism, had been one of the great forces contributing before the war to the uniformity of monetary conditions in Europe.

THE WAR AND THE MONETARY SYSTEM IN BELGIUM

The complexity of economic and monetary events in Belgium makes it necessary to give up a chronological treatment, in order to give preference to the grouping of ideas bearing on a single question. The necessity of condensing into a few pages the analysis of situations arising from an entanglement of causes, certain of which, entirely psychological, are almost imponderable, requires, unfortunately, tracing in outline a period of the monetary history of Belgium that, in reality, should occupy a volume. More detailed analysis of the statutes of the Bank of Issue is postponed to Section III. Let it suffice now to say on this subject that Belgium had a private central bank of issue, the National Bank of Belgium, enjoying a privilege transformed into a *de facto* monopoly. The government was not indebted to the Bank and had no paper in circulation. The situation of the country was very sound. The reserve could not go below a third of the sum of the sight liabilities except with the authorization of the Minister of Finance.

On June 30, 1914, the National Bank of Belgium had a circulation of 1,007,500,000 francs, and the current creditor accounts amounted to 113,500,000 francs.

Banking Crisis of 1914. The declaration of war on Serbia by Austria caused, at the end of July, 1914, a banking crisis in Belgium, manifested by the withdrawal of deposits from the private banks and demands for the redemption of notes by the National Bank of Belgium. To meet the crisis, the Bank of Issue rediscounted the commercial portfolios of the banks, and between July 25 and August 6, the Bank's holdings of Belgian commercial paper rose from 425 million francs to 818 million. The discount rate was raised from 4 to 7%. Extensive and liberal redemptions of the Bank's notes at the head office in Brussels and in the provincial agencies did not stop the panic, especially since the hoarding of specie caused a scarcity of the smaller media of payment, the bank note of the lowest denomination being that of twenty francs.

For several years past, in anticipation of international political complications leading to forced legal tender, the Bank had

printed five-franc notes that it kept in its vaults. The government authorized their issue, which had the effect of placating the public. On the second of August, the ultimatum of Germany to Belgium, demanding free passage for her armies through the neutral territory of the country, made it apparent that war was inevitable, and that very evening the King signed two decrees establishing a moratorium of commercial paper and a forced legal tender quality for the notes of the National Bank of Belgium. On August third, the Bank's metallic reserve was transferred to Antwerp, a stronghold that was to serve as a last refuge, and where the army was to retreat in case of necessity. In spite of the enormous rediscounting of the commercial portfolios of the banks, several that had considerable credits abroad found their available funds exhausted. The statutes of the Bank forbidding it to make advances on other assets, the banks formed a consortium with limited joint liability to furnish the second signatures on the promissory notes of credit establishments. These promissory notes, reënforced by security, could be discounted by the institution of issue.

In fact, the consortium had an excellent moral effect that checked the panic. In addition, a royal decree of August 3, established a moratorium of bank deposits, limiting withdrawals to a thousand francs in fifteen days.

Following the withdrawal of specie and the issue of notes, the Bank's reserve had fallen on August 7, 1914, from 44.4% of the amount of its sight liabilities (bank notes and current accounts) to 27.7%, the legal minimum being 30%. The government authorized this infringement of the statutes.

We shall not dwell on the seizure of the reserves of the agencies of the National Bank of Belgium — a private company — by the German troops in violation of the Treaty of the Hague of October 18, 1907. As soon as it was aware of this, the administration of the National Bank of Belgium had all its securities sent to Antwerp, those of the Belgian State, of which it was fiscal agent, and its notes, molds and plates.

Neither shall we enlarge on the constant struggle of the administration of the National Bank of Belgium with the German military authorities, who had immediately appointed an "Imperial General Commissioner of the Banks in Belgium." As these con-

flicts bear on judicial and economic questions, we refer the reader to the *Report to the King* published in 1918 by the National Bank of Belgium.

WITHDRAWAL BY THE GERMAN AUTHORITIES OF THE RIGHT OF ISSUE FROM THE NATIONAL BANK OF BELGIUM

On the eve of the taking of Antwerp, the reserve and the securities of the National Bank of Belgium were transported from that stronghold to London, to the Bank of England. The Belgian Government having refused, for obvious reasons, to repatriate this reserve in Brussels, the German Governor General in Belgium dismissed the Governor of the Bank and the Commissioner of the government. On December 24, 1914, the right of issue was withdrawn from the National Bank of Belgium by the German authorities, who granted it to the Société Générale of Belgium.

Right of Issue Confirmed to Société Générale. In the financial and monetary history of the world, this measure is sufficiently extraordinary to be dwelt on. Without wishing to enter into discussions of doctrine, we may, however, note that the energetic attitude of the National Bank of Belgium arose from the fact that it was a private institution which the government could not control like a state institution. It was without enthusiasm that the Société Générale of Belgium accepted its mission, in full agreement with the National Bank of Belgium, with the ministers remaining in Brussels and with some of the best jurists of the country. Let us cite here some extracts from the official report relative to this acceptance:

"The closing of the National Bank of Belgium, following the withdrawal of its privilege of issue, would inevitably entail that of other banks and would have the most unfortunate consequences for the domestic security of the country, on account of the complete cessation of commerce and industry and the famine that would soon result from it for the whole population.

"The consortium of the bankers of Brussels, in response to the desire of the Belgian Government, has sought a means of replac-

ing provisionally the issue made by the National Bank of Belgium with that of a temporary organization to pass out of existence immediately on the conclusion of peace. The consortium has agreed unanimously that the most practical solution, and the one entailing the minimum of German interference, consists in authorizing the Société Générale of Belgium to create a department of issue, permitting the centralization of discount operations and advances on public securities as they are practiced by the National Bank of Belgium.

"The Société Générale has agreed in principle to take charge of this mission, it being expressly understood that it shall do so for the exclusive profit of the National Bank and also under the entire responsibility of the latter, and that, immediately on the conclusion of peace, it will liquidate the department of issue it is to create."

It was, moreover, morally impossible for the Société Générale to refuse to fulfill this mission, the German authorities having added that in default of payment of the war taxes by means of bank notes, they would put into circulation requisition notes which would be made forced legal tender.

An agreement signed January 14, 1915, by the National Bank and the Société Générale stipulated that three months at the latest after the conclusion of peace, the notes issued by the Société Générale should be exchanged for notes of the National Bank.

THE SEIZURE OF THE RESERVES IN MARKS BY THE GERMAN GOVERNMENT

The expenses of the German administration and the personal expenditures of the officers and soldiers had brought into Belgium considerable quantities of the Reichsbank's notes, payable in marks and issued at the rate of 1.25 francs (par 1.23).

The Reichsbank was extremely anxious to repatriate them, for the German notes in circulation in Belgium had to be replaced by others in the interior of the Reich, which increased by that amount the issues which the Imperial Bank wished to restrict as far as possible. These German notes, little favored by the Bel-

gian populace, flowed into the vaults of the National Bank of Belgium.

As early as 1916, the Germans tried to repatriate them, and proposed that the National Bank of Belgium convert these mark notes into interest yielding credits with German banks. The Bank refused through patriotism. This question of the return of the marks to Germany was to arise again at the Armistice. As early as August 31, 1916, the German Commissioner pointed out the danger of not obeying the occupation authorities in regard to an eventual course of redemption.

" The withdrawal of the marks has another important side; it is the assurance that can be given that the redemption on the basis of 1.25 francs of the marks repatriated by the National Bank and the Department of Issue [of the Société Générale] would be guaranteed by a syndicate of large German banks.

" The representatives of the German authorities can only urge the National Bank and the Deparment of Issue to take this course; it is an opportunity to obtain the redemption of the marks at 1.25 francs that will be offered only once, and if the National Bank and the Department of Issue do not consent to it, they must not in the future, even at the moment of the discussion of peace terms, consider bringing up such a negotiation again."

The directors of the National Bank and of the Société Générale answered that " they could not consider separating the marks in circulation among the public from those constituting the reserves of the National Bank and the Department of Issue; all discussion that can be opened must bear on the total of the marks in Belgium."

Finally, under the menace of a forced liquidation and the sequestration of the two establishments — a liquidation that would have had the most distressing consequences for the country — the German authorities had the marks seized and transferred to Germany. In spite of constant efforts to avoid the accumulation of marks in the banks, a billion and a half francs in marks reckoned at 1.25 francs were thus seized and gradually sent to Germany.

It is important for the comprehension of what follows, and in order to understand the nature of the inflation in Belgium, to re-

member that the National Bank of Belgium and the Société Générale had constantly striven:

(1) to hinder by all possible means the increase of the fiduciary circulation of the Department of issue;

(2) to make the German money circulate and thus prevent its accumulation in the National Bank or the Department of Issue, where it was seized by the German authorities and transferred to Germany.

THE ARMISTICE AND THE EXCHANGE OF THE MARKS

On November 19, 1918, on the eve of the liquidation of the Department of Issue, the circulation of its notes reached 1,153 million, and its current accounts 335 million francs. At the date of the Armistice, the total circulation of Belgian notes reached 2,800 million francs, including the notes of the Bank and those of the Department. It is also necessary to take into account the German marks in circulation, which, issued at the rate of 1.25 francs, were quoted at that time at 65 and 70 centimes.

The Monetary Restoration Loan. Two decree-laws of November 9, 1918 by the Belgian Government at Havre stipulated the redemption of the marks at the rate of 1.25 francs; but with a view to a reduction of the fiduciary circulation, it was decided to issue immediately a loan for purposes of monetary restoration at 5%, maturing in three years, subscribers having the privilege of making payments to the amount of three-fourths of the sum of the subscriptions in marks at 1.25 francs. The exact figure of the marks exchanged for francs reached 6,109,000,000 marks or 7,635,000,000 francs:

(a) subscription to the Treasury Bonds for Monetary Restoration	Mk. 1,545,000,000
(b) direct exchange	Mk. 2,855,000,000
(c) marks coming from Germany in restitution to banks and individuals	Mk. 1,700,000,000
(d) exchange for prisoners of war	Mk. 7,000,000
(e) supplementary exchanges at 1 franc per mark	Mk. 2,000,000
Total	Mk. 6,109,000,000

It was necessary to appeal to the National Bank of Belgium in order to obtain an advance for exchanging the marks. Thanks to

the subscriptions in marks to the loan for Monetary Restoration the State could limit the advances made to it by the institution of issue to 5,800 million francs in notes.

Liquid Funds Concentrated in Banks. As the means of communication were destroyed, as the German army during the occupation had systematically organized the seizure and transportation into Germany of all the industrial equipment of Belgium,[1] and as foreign commercial relations were interrupted, the country was paralyzed, incapable of resuming its great pre-war activity. The result was that the quantity of currency was much too large and the liquid resources of the country were concentrated in the banks, which, in their turn, left enormous deposits in current accounts in the National Bank. "Therefore, in the beginning," says Professor Chlepner, "it was not so much the actual circulation as the potential circulation that increased: that is to say, the deposits in the National Bank of Belgium. But in proportion as activity was resumed, the demands for notes were multiplied, deposits were reduced and circulation increased. At this time, the exchange was not debased to the point of precluding the idea of revalorization, and prices had not become adapted to the circulation." Certain prices had risen formidably during the occupation; this was the consequence not only of the abundance of currency but also of the scarcity of certain agricultural products — butter, eggs, milk, potatoes — that had been requisitioned, or colonial products — coffee, tea, spices, rice, chocolate — the supplies of which had been exhausted for a long time.

At this moment, a new deflation measure similar to the one accomplished by the loan for the Monetary Resolution might perhaps have been possible. But before placing blame, it is necessary to take into account the frightful state of disorganization of the country, the formidable advances granted by the government to manufacturers ruined by the war, and the almost complete cessation of revenue from taxes, following the total paralysis of industry. Before considering monetary reform, the Belgian

[1] The writer of these lines visited personally at the end of 1918 and the beginning of 1919 important factories for the construction of locomotives, railroad cars and automobiles in the Charleroi industrial district. He ascertained that in the shops only the brick framework of the motors remained, all the fixed equipment having been sent to Germany, where it was gradually recovered and restored to the Belgian proprietors.

Government had literally to feed and employ the whole population of the country; industrial reconstruction was the dominant preoccupation.

The government, nevertheless, did redeem at the Bank as much as 600 million francs.

The Treaty of Versailles enjoined on the Germans to conclude with the Belgian delegates a special convention for the redemption of the marks left in Belgium by their armies. They have recognized this debt from the judicial point of view, but up to the present the Belgian Government has never been able to obtain satisfaction, although it always asserted its rights.

How may the operation of the withdrawal of the marks be judged? According to sound theory, few authorities approve it, but if the social and political conditions of the time when the decision was made be taken into account, it is difficult to blame the rulers of the country for this step.

The French authorities acted in the same manner with the marks left in Alsace-Lorraine — Rumania was also confronted with the same problem.

"However it may be," writes M. Louis Franck, Governor of the National Bank of Belgium, "the effects of the liquidation have not been felt too keenly. All the world's merchandise was at a very high price; everywhere there was inflation; confidence in the notes of the National Bank, the reappearance of which was received with joy, was absolute; almost everybody believed in a rise of the mark and the rapid repayment of the reparations due from Germany; finally, the government placed its loans easily, thanks in part to the abundance of the mediums of payment created by the inflation."

The Exchange. In Belgium, several years before the war, foreign exchange, particularly in Paris, was at a slight premium: three to four per thousand. Certain economists attributed this slight loss to the permanent deficit in the balance of accounts, resulting from over-investment of capital abroad. Others gave as the cause of this weakness of the Belgian exchange the inadequacy of the discount policy of the National Bank of Belgium.

Belgian Exchange Fell Slowly. During the war, inter-allied agreements and the credits open to Belgium deprived the Belgian exchange rate, in respect to the dollar and the pound, of

significance. But the announcement of the termination, in March, 1919, of the solidarity of exchange among the Allies should, it seems, have led to the rapid depreciation of the Belgian franc. Nothing of the sort occurred, and there appeared the paradoxical spectacle of a ruined country, afflicted with inflation, and balancing its budgets only by means of immense loans, having a formidable deficit in the commercial balance, with an exchange that was debased but slowly. The cause can be attributed to the special credits given Belgium, foreign exporters not repatriating the proceeds of their sales but leaving them on deposit in Belgium in the hope of a rise of the franc. The incredible confidence of the great Belgian public in the national currency can also be cited. At that time, too, many Belgians converted their foreign portfolios into Belgian francs.

THE RISE OF THE £. "Little by little," says M. Franck again in his book on *Monetary Stabilisation in Belgium,* "the falling money market, fatal when there is inflation, developed. The pound, which had remained for some time at 35 francs, went to 50, then to 80 francs. It fluctuated for rather a long time between 90 and 95 francs. From May 1925 to March 1926 it remained around 107." Naturally there were highs and lows, and, in 1923, the Belgian and French francs were the object of active speculation, which alarmed the populace: "French and Belgians bought foreign exchange, thus contributing to the fall of the franc."

EFFECT OF EXCHANGE FLUCTUATIONS ON COMMODITY PRICES. The fluctuations of the domestic buying power of the Belgian franc followed, approximately, the fluctuations of its buying power abroad. Wholesale prices in Belgium remained at about the level of prices in the great world markets, being only a trifle behind. But the retail prices of foodstuffs followed the general movements of the exchanges, the indexes remaining perceptibly behind the wholesale prices and the exchange; the prices, converted into gold at the rate of the appreciated exchanges, remained much lower than foreign prices, except in 1921, when world prices fell suddenly, bringing wholesale prices down more rapidly than retail prices.

Obviously we cannot analyze here the efforts of the government to hasten reparation payments, to balance the budget and to raise taxes.

We shall simply say that for 1914 the Belgian budget of ways and means provided for receipts from taxes amounting to 354 millions. For the year 1926 the budget reached 4,328 millions.

	1914		1926	
	million frs.	%	million frs.	%
Direct taxes..................	87.1	24.6	1,796	41.5
Customs and excises...........	168.4	47.5	1,071	24.7
Inheritances..................	66.6	18.8	145	3.4
Stamps and Registries.........	32.1	9.1	1,316	30.4
Total......................	354.2	100	4,328	100

This table reveals a complete fiscal revolution.

The Minister of Finance strove to balance the ordinary budget while incorporating therein expenses that, on account of peculiar post-war circumstances, had been incorporated in the budget of recoverable expenses, or in the special budget.

The budget of recoverable expenses consisted of the advances of the Belgian State to the war sufferers. On June 30, 1924, the account of the damages that had been assessed and entered to the debit of Germany, was made up of the following items:

	In millions of francs
War tax, interests on restoration loans	5,474
Damages to public property..........................	4,293
Damages to private property: factories, etc............	8,173
Personal damages: the disabled, deportees.............	1,054
Miscellaneous	988
Total	19,982

There should be added expenses occasioned by the withdrawal of the marks remaining in the vaults of the National Bank of Belgium.

Monetary Stabilization Attempted. The franc having remained at 107 to the pound for several months, the Government in power submitted a bill on November 12, 1925, relative to strengthening fiduciary circulation and monetary stabilization.

The bill was based economically on a *de facto* establishment of the gold exchange standard. To furnish sufficient cover for fiduciary circulation, the Belgian Government was to contract

abroad a loan of 150,000,000 dollars, the proceeds of which, converted into exchange, would serve both to redeem the debt of the State to the National Bank of Belgium and to meet demands for gold or exchange for foreign payments. The balance of the debt to the State was to be paid through an accounting operation: the revaluing of the gold reserve of the institution of issue.

The bill provided that the stabilization rate be fixed by royal decree determined in the cabinet, as well as a prolongation of the privilege of the Bank of Issue.

The course of the respective exchanges made it possible to make the Belgian franc independent of the French franc. The attempt failed. The government then in power was composed of Socialists and Christian-Democrats and it was exposed to very bitter attacks from the conservative opposition. The foreign loan promised by foreign banks was not granted under circumstances that have remained obscure; — partly because the lack of confidence in the interior spread abroad.

Theoretically, the first plan of stabilization was irreproachable, but the Cabinet made certain political mistakes, and in addition did not take sufficiently into account the need of avoiding a return of inflation by consolidating the floating debts. In March, 1926, the latter reached 4,500,000,000 francs, 1,800,000,000 of which came due in December. The Cabinet was also reproached with having established only a precarious budgetary balance.

The reform was to entail and, in fact, had already led to, a rise in the discount rate and a policy of restriction of credit, keeping the media of payment within the limit necessary for maintaining the rate. The need of this action was all the greater since it was necessary to stop demands for credit emanating from manufacturers and merchants long accustomed to the easy methods of the inflation period. Now the existence of a floating debt, a large part of which was held by the banks, would defeat any restrictive credit policy for private banks, and individuals procured necessary resources by not renewing Treasury Bonds. In fact, as Professor Baudheim has clearly demonstrated, the redemption of Treasury bonds exceeded their renewal since the Socialists and Christian-Democrats came in office.

It was the large notes held by the banks that were not renewed. From 1,800 million francs in September, 1925, they fell to 500

million francs on March 10, 1926. Forced consolidation, therefore, should have been resorted to, but the government dared not take that measure. To meet the demands for repayment, the government issued short-term Treasury Bonds, payable in exchange, which it placed abroad, and borrowed from the National Bank.

In the midst of these negotiations and the increasing anxiety of the public, suddenly, on Monday, March 15, 1926, the pound rose in an hour from 107 to 122 francs. In the course of the following weeks, the financial crisis was augmented, especially since the French franc involved the Belgian franc in its fall. It must be added here that French opinion had been quite unfavorable to making the two monetary systems independent of each other and the passing of Belgium to the group of gold standard countries.

On May 7, the pound was quoted at 162.37 francs. The rise of the exchange and of the cost of living had upset the budget established on the basis of the pound at 107 and the wholesale price index at about 520. The Treasury was at the end of its resources, demands for repayment flowed in and the government, unable to consolidate, brought pressure on the institution of issue in order to obtain advances. The National Bank yielded to the demands of the government only with the most marked reluctance, foreseeing all the consequences of a suspension of state payments. But in acquiescing, it exacted the sanction of the Chambers for the discount of the new Treasury Bonds. On May 18, the Chambers passed a bill authorizing the government to obtain new advances from the Bank to the amount of 1,500,000,000 francs.

The situation was tragic: after more than a seven-year struggle against the temptation of inflation, the government yielded to it at the very moment it had passed laws for monetary reform.

The note circulation progressed as follows:

March 25, 1926............	7.495 million francs
April 24, 1926..............	7.925 million francs
May 24, 1926..............	8.307 million francs

The Coalition Ministry. On May 25, a new coalition ministry appeared before the Chambers. This Cabinet carried out certain economies, that had an excellent influence on opinion which had been greatly indisposed towards the public administration by

press campaigns. It also voted 1,500 millions in new taxes, to be placed in a sinking fund for the public debt, created to administer, on the one hand, ordinary appropriations destined, according to the laws and the contracting of loans, for the repurchase or repayment by drawing of the notes of the consolidated debt, and, on the other hand, the special resources destined by the present law (June 7) to the reduction of the public debt in general, domestic as well as foreign, and long term as well as short term, including the Treasury Bonds discounted by the National Bank in accordance with the law of May 19, 1926.

Use of Credit of Railways. As it was necessary to insure resources for the Sinking Fund immediately, it was decided to use one of the State's assets: the railways which heretofore were state managed. A National Company of Belgian Railways was formed, charged with exploiting the State railways, with a capital of 11 billion francs, 10 billion of which was represented by preferred stock and one billion by registered and non-transferable common stock. The total stock was returned to the State in remuneration for the right of exploitation granted the association; it kept the common stock, but transferred the preferred stock to the Sinking Fund, with instructions to negotiate it or exchange it for Treasury Bonds.

Continued Rise of Foreign Exchanges. June and July did not see public opinion calmed or the movement of the exchange checked. On June 30, the pound was quoted at 173.25 and July 13, at 217; the Belgian franc had fallen below the French franc. The redemption of Treasury Bonds continued and the withdrawal of capital took place on a large scale.

Drastic Measures Taken. On July 16, a law was passed granting plenipotentiary powers to the Executive for six months to assure monetary reform.

On July 31, the Treasury minister, a new office, which duplicated that of Minister of Finance and was held by the powerful banker, Mr. E. Trancqui, decided on the forced consolidation of the six months Treasury Bonds and five-year bonds maturing December 1, 1926 into preferred stock of the National Association of the Railways.

Certain measures were taken to mitigate the severity of this decision: bearers could present their bonds for stamping in order

to preserve their character of Treasury Bonds, which would be redeemed only according to the available assets of the Sinking Fund through drawing by lottery. The Minister of Finance, with the agreement of the Treasury, had the power of concluding with savings banks, and credit and public utility organizations that had had their securities stamped, special arrangements, by virtue of which these securities could be exchanged for special bonds. Only a quarter of the bonds were presented for stamping.

The pound fell rapidly, with, however, several rises of short duration:

July 30, 1926	192,50 frs.
August 31, 1926	174,75 frs.
September 1, 1926	173,25 frs.
September 14, 1926	172,— frs.
September 20, 1926	171,40 frs.
September 30, 1926	178,— frs.

The National Bank of Belgium had at the same time restored and increased its exchange reserve, and the government redeemed certain provisory credits. The industrial situation was favorable and the state of mind much better; the public, previously so recalcitrant, accepted all the measures of the government. On October 23, a loan of a hundred million dollars was obtained, and on October 25 a royal decree stabilized the franc at 175 to the pound sterling.

The Stabilization Decrees. The second reform, having been crowned with success, is worthy of attention from the point of view of its theoretical aspects. In its broad lines, it followed the first laws; in fact, the royal decrees of October were made to carry out the monetary laws of February 26, 1926. They rest equally on the principle of the gold exchange standard, on the repayment of the debt of the State to the Bank by means of a loan in foreign currencies intended to reënforce the cover of the notes, and on a revaluing of the gold held in the vaults of the National Bank of Belgium. The rate chosen was different, but circumstances were different. Up to the present, the course taken seems judicious, but only the future will make it possible to formulate a final judgment. The royal decree of October 25 also renewed the privilege of the National Bank of Belgium under terms that will be treated later.

The Belga. But an important provision was made in order to give to Belgium a coin different from that of other countries (Article 8, Royal Decree of October 25, 1926): "The exchange of the Belgian franc abroad is established on a multiple of five francs. The National Bank adopts the same multiple as the basis of its payments in specie, which shall be made on demand in gold, in silver at its gold value, or in foreign gold exchange as the Bank chooses.

"This multiple alone is quoted on the exchange and has, for that purpose, the name of 'Belga.'

"It is forbidden to publish the exchange of the Belgian franc in any other form.

"Parity with foreign moneys is established at the rate of 0.209211 gr. of fine gold to the belga."

Article 9. "If the National Bank issues notes payable on the basis of Article 8, they shall carry at the same time mention of their value in francs.

"Notes payable only in francs shall be at any time exchangeable for notes payable in Belgæ in the proportion of five to one."

Lastly, the government has taken over to its account the five and twenty franc notes (about 800 millions), to circulate henceforth under the Treasury seal. Following the monetary depreciation, these notes correspond, approximately, in buying power, to the pre-war silver coins, the minting of which was reserved to the State, by virtue of its sovereign power. The Treasury notes will be replaced later by five and twenty franc silver pieces.

M. Franck, Governor of the National Bank of Belgium, thus explains, in his book already cited, the creation of the belga: "There are only two practical formulæ of stabilization. One consists of adopting a rate of exchange fixed in relation to a money with a gold basis: pound, dollar, florin. This means being placed in dependence on another monetary system. The other formula is to make gold the standard; this is the best. But in this case, either the existence of the gold franc must be sanctioned or a new metal par adopted.

"To sanction the existence of a gold franc and a paper franc would mean being exposed to all kinds of grave disadvantages in the interior.

" But, on the other hand, it was of the greatest importance to preserve the circulation of the franc in the interior, to avoid upsetting the price market, not to cause anxiety of mind and an abrupt unsettlement in the prices of commodities and wages in the interior of the country.

" Therefore the new unit was to be incorporated in the monetary system of the franc.

" Finally, all these conditions being realized, there was reason, according to all evidence, to give this new unit a new name.

" This is the combination of considerations that led to the proposal to the government of the system that has been adopted."

The Foreign Loan. The loan of 100 million dollars was negotiated with an international group including, in England, Messrs. Baring Brothers and the Westminster Bank; in the United States, Messrs. J. P. Morgan and Company; in Holland, Messrs. Hope and Company; in Switzerland, the Swiss Banking Association; in Sweden, the Stockholm Enskilda Bank.

In addition, the Bank of England, the Federal Reserve System of the U. S., the Reichsbank, the Nederlandsche Bank, the State Bank of Sweden, and the reorganized banks of issue of Austria and Hungary, granted the National Bank of Belgium rediscount credits.

" There was no question at this time, very naturally, of any but the central banks in countries with a gold standard," writes M. Franck, " With great vision, the Bank of France and the Bank of Italy were anxious later to give Belgium a new proof of sympathy by joining the other central banks."

The Present Monetary System of Belgium. At present, as a matter of fact, the Belgian monetary system comprises only monetary counters and bank and Treasury notes.

Gold and silver coins still exist, but they no longer circulate and the Bank buys them from the public by weight, at the rate of the fine metal which they contain, for their market prices obviously greatly exceeding their face value. This situation will be modified sooner or later.

The five- and twenty-franc notes, to be replaced in the future by metal coins, circulate for the account of the Treasury. There are in circulation notes of the National Bank of Belgium for 1,000, 500, 100 and 50 francs. They are payable on demand, in

gold, in silver at its gold value, or in foreign exchange, as the Bank chooses. The Bank has begun to issue notes payable both in francs and in belgæ.

Lastly, monetary counters exist in nickel for two coins, for 1 and 0.50 francs, the legal tender value of which is limited to fifty francs between individuals.

The legal tender value of the cupro-nickel pieces of twenty, ten and five centimes is limited to five francs between individuals. There are also two and one centime copper pieces having legal tender value only to the amount of two francs.

INSTRUMENTS OF CREDIT

The Draft. The *bill of exchange* or *draft* or *bill to order* without doubt constitutes the credit instrument most widely used in Belgium, and the one most readily discounted by banks.

The law of May 20, 1872 determined the legal control of the bill of exchange. It must be dated, and state: the sum to be paid, the name of the person who must pay, the time and place of payment, the name of the one to whose order the bill is drawn, either a third person or the drawer himself. It is transferable by *endorsement*.

The *accepting of a bill of exchange* is the act through which the drawee, by setting his signature to the paper, contracts toward the bearer the personal obligation of paying the draft on maturity. In order to encourage the practice of acceptance, which constitutes an assumption of the genuineness of the underlying transaction, the National Bank has established a more favorable discount rate for accepted drafts.

Between merchants and for commercial debts, the creditor has the right, except in the case of agreement to the contrary, to draw on his debtor a bill of exchange not exceeding the sum of the debt, and the drawee is bound to accept it. In practice, however, there are still commercial organizations that never accept drafts drawn on them while recognizing that they owe the amount stated on the paper which they settle on maturity. According to the statistics of the National Bank of Belgium, the amount of acceptances is smaller than that of the sum total of unaccepted drafts and promissory notes.

Before acceptance, the drawer remains the principal debtor of the bearer; by acceptance, the drawee, whether he have funds or not, becomes the principal and direct debtor for the amount of the draft to the bearer, whosoever he be. (Smeesters) However, the drawer and successive endorsers still remain jointly responsible to the bearer if the drawee allows the paper to be protested. Their liability is, however, only one of surety. The bearer can resort indifferently to any one of the endorsers or the drawer. Failure to meet the draft on maturity occasions a *protest,* drawn up by an officer of the law or a postal employee. The judges can grant no delay for the payment of a draft; there are no days of grace as in Anglo-Saxon legislation. All suits arising from bills of exchange are outlawed in five years.

On account of the joint liability of the bearers, the bill of exchange constitutes the best credit instrument, transferable by endorsement and without formality. In practice, the negotiability of bills of exchange is limited to one or two endorsements. It would be correct to say that they are easily transferred but that they circulate little. The National Bank discounts at the rate for accepted drafts, unaccepted drafts payable at a bank.

Promissory Notes. The *promissory note* or note *payable to order* is a commercial paper constituting for the drawer a promise to pay at a certain date a certain sum to another person or at his order. Like the draft, the promissory note can be payable on demand or on a stated maturity. All the legislation bearing on the draft is applicable *mutatis mutandis* to the note payable to order. Owing to the special and personal character of the obligation, the promissory note constitutes a less desirable instrument of credit than the draft, and is much less readily negotiated. The promissory note does not offer a certainty that the sums proceeding from its discount will be actually used for productive and commercial operations. It is a paper of a character more financial than commercial; it is generally drawn to represent advances made by a bank to its customer. The National Bank of Belgium receives promissory notes for discount and rediscount at the rate in force for unaccepted drafts. The promissory notes received for discount by the Bank must generally be accompanied by proof of the commercial nature of the transaction.

THE BANKER'S ACCEPTANCE. When a banker wishes to take part in a credit transaction without tying up his own funds, he can authorize a customer to draw a draft on him that he accepts. By means of this credit paper bearing two signatures, the customer may, by having it discounted, procure the sums he needs. The discounting bank thus has a double guarantee, from the drawer and from the accepting bank.

In international transactions, the banker also sometimes accepts a draft in the stead and place of his customer, in order to facilitate for the foreign seller, the discounting of the paper by means of a known signature.

These practices are not, of course, peculiar to Belgium. They are mentioned here only to point out that there are no legal limitations, and that banks can engage in the acceptance business without any limitation. There is an acceptance market, of restricted activity, partly in the hands of foreign banks. The falling off of economic relations with gold standard countries during the monetary disturbances affecting Belgium, caused Belgian banks to furnish acceptances for the accounts of their customers or to stand " del credere " in order to permit them to obtain credit in the United States, Great Britain, Holland, etc. As a result, the liabilities of the banks for acceptances for their customers' accounts appear in the balance sheets of the banks for ever increasing amounts. However, their present importance should not be exaggerated.

THE CHECK. The check is regulated by the law of June 20, 1873, supplemented by that of May 31, 1919. In spite of the great advantages it offers, the check is not widely used in Belgium (nor, indeed, in the other countries of continental Europe) as it is in the Anglo-Saxon countries; however, its use is becoming more and more general, thanks to the establishment of clearing houses in Brussels and at the provincial branches of the National Bank of Belgium. It is especially employed for large payments and is almost unknown in small business. The " crossed check " is used much less. It is fair to add that the educational campaign of the National Bank and the government, and the founding in 1913 of a service for postal check accounts, and the official opening of credit accounts for state employees and purveyors, as well as the expansion of international economic relations, have, since the

war, greatly increased the circulation of the check. The legislation of 1919 in regard to the crossed check helped to modify public opinion on this excellent means of payment.

The Warrant. The law of November 18, 1862 regulating the warrant constitutes to some extent the mortgage law on merchandise. Before 1862, to render the pledge possible, it was necessary to surrender the goods to the creditor or a designated third party, and therefore the debtor, the owner of the goods, could not transfer them again.

The warrant permits the creditor to transfer his collateral and its owner to transfer to another his right of ownership of the merchandise without endangering the rights and liens of the creditor.

"The *warrant* is a commercial instrument delivered in two parts, *by a third,* to the person proving to have free disposition of the merchandise that is the basis of the instrument. The second part is called the schedule or inventory." The warrant accompanied by the inventory represents the free disposition of the merchandise. The warrant without the inventory represents the possession of the merchandise in the title of collateral. The inventory without the warrant represents the right to dispose of the merchandise, but subject to the lien represented by the warrant. The bearer of the warrant possesses an absolute lien on the merchandise. The merchandise pledged must be deposited in public warehouses or in private warehouses or in storage houses belonging to a third. The mechanical execution of the warrant consists in depriving the owner of the free material disposition of the merchandise, so as to render the pledge effective: thus, the warehouse receipt delivered by the public warehouse must be made out in the name of a third who delivers the warrant. The third is considered the depositor of the merchandise.

The warrant can be indorsed as a bill of exchange. On the conclusion of a discounting operation, mention should be made on the warrant of its application as collateral for the obligation contracted.

The National Bank of Belgium, which negotiates numerous loans on warrants at its branch in Antwerp, the most important port of continental Europe, has made up a list of merchandise subject to warrant; it is very comprehensive and constructed so

as to favor extensive international commerce. Specialized corporations and coöperative societies assume the rôle of the third party issuing the warrant. For the warrant of sugar, especially raw foreign sugar brought into the country for refining and destined for reëxportation, the operation of the warrant is carried out as follows: in default of a public warehouse, the warranting company rents one or more storage warehouses of the sugar refinery for a nominal rent. In these warehouses, the use of which is reserved to the third party, the warranted sugar is placed. This constitutes legal surrender of the merchandise into the hands of a third party. The latter issues the warrant and is responsible to the bearer for the genuineness of the relinquishment. As sugar is subject to excise duties, the revenue office and the Bank have an equal interest in insuring the preservation of the sugar in good condition and a certain *de facto* coöperation in the matter is established. The system is similar to the "fictitious bond" applied to foreign sugar destined for reëxportation. Since the Armistice, the private banks have extended their loan operations on warrants particularly adapted to agricultural credit.

Agricultural Drafts. It will be seen (Section III) that the National Bank of Belgium receives for discount and rediscount drafts and promissory notes representing transactions bearing on agricultural products or farm implements. Nevertheless, agricultural credit does not have the importance in Belgium that it has in the United States: the system of rotating crops and the simultaneous practice of stock raising, dairying and cultivation constantly furnishes the farmer with a working capital. Therefore the financing of the harvest is less troublesome than in highly specialized rural exploitation. Also, grain production is unimportant on account of the requirements of a very dense industrial population, and the Belgian cultivators strive rather to develop truck gardening, fruit growing, and the production of meat, butter and eggs. Agricultural credit is practiced principally by coöperatives of farmers; the most important is the Boerenbond. The Postal Savings Bank deals to some extent in rediscount of agricultural drafts. The farmer sells his wheat readily, soon after threshing, and we have never found an example of direct warranting by the cultivator, of grain or sugar beets. It is the grain

merchant, rather, who, after the purchase of the crop, must resort to the warrant. For sugar beets, the seeds are furnished by the sugar refinery and the crop, bought on terms that are settled before sowing, is delivered as it is dug.

In a country as industrial as Belgium, where the land is divided into small parcels and submitted to a cultivation as varied as intensive, agricultural credit can give rise to national problems only in exceptional circumstances. The dairy and truck products find an easy daily outlet in England, Holland, and Germany.

Mortgage. The mortgage is a civil means of constituting a real estate pledge to serve in furnishing guarantees in support of a credit transaction. The mortgage is drawn up before a notary, in return for the payment of rather high registration fees. The mortgage deed is not negotiable. There can be no substitution of mortgagee. The mortgagor, on the other hand, can transfer freely the mortgaged property, over which the mortgagee preserves all his rights, no matter into whose hands the real estate passes. On account of the legal complications it entails and the relatively large expense it necessitates, the drawing up of a mortgage is only considered in the case of a long term credit transaction.

The rural mortgage has greatly diminished in importance since the war, thanks to the considerable profits realized by the peasants, who have been able to free themselves from debt. From official information obtained by the registry administration, it would appear that the farmers had, since the Armistice, freed from mortgage or bought rural securities for more than 4.5 billion francs. There has been in reality a formidable displacement of property in favor of the direct exploiter. This phenomenon occurred in Germany before 1923, but since then, the agricultural crisis has caused the peasants to go into debt again, but for short terms. The same phenomenon is also occurring in Belgium. Since the fall of 1927, a mild crisis is affecting Belgian agriculture and from several districts of the country, information tends to indicate that the farmers have again recourse to credit, especially for buying land, whereas a few months ago they always offered ready money.

INVESTMENT CREDIT INSTRUMENTS

Stocks. In our opinion, what constitutes the most characteristic feature of Belgian legislation controlling corporations in the eyes of a foreigner is the protection with which the law surrounds the issue of stock.[2] We do not claim, however, that fraud is non-existent in Belgium and that it is not possible to form fictitious and fraudulent companies. But it seems, nevertheless, that there are certain limits that dishonest people cannot exceed without being directly exposed to the severity of the penal code, and that the law has endeavored to surround the investment of capital with certain guarantees; there are not to be found in Belgium scandals similar to those cited by Liefmann in the United States; all legal and joint acts of corporations: charter, increase or reduction of capital, stockholders meetings, presentation of the balance sheet and the account of profits and losses, and liquidation, must be published in detail in the supplements of the *Moniteur Belge* (the journal of official publications) and be registered. (Law of May 18, 1873, last amendment in 1919). The charter is an act that must be drawn up before a notary. Four fundamental conditions are required. It is necessary:

(1) that there be at least seven stockholders;

(2) that the company's capital be subscribed in full;

(3) that one-fifth at least of each share be paid up in cash or negotiable collateral;

(4) that the fulfillment of these conditions be recorded in an authentic act.

The stock is a security representing a share of ownership in the capital of the organization. The stockholder shares in the profits and losses to the amount of his investment. A right of control is attached to his security. Except in the case of fictitious subscription and paying in (check without funds, etc.) of the shares, the amount of the capital must be subscribed by persons who, by partially paying for them, assume a certain risk that renders

[2] A comparative study of American and Belgian legislation on stocks and bonds issued by companies would be extremely interesting. Unfortunately, it would take us far afield. We refer the reader, on this subject, to a collective study published by the Solvay Institution of Sociology.

them more circumspect and less disposed to the fraudulent creation of a "bogus company." The collateral is subject to certain stipulations intended to prove its real value: condition of real estate as to mortgages, etc.[3]

Methods of Providing Capital. The law offers two different methods of providing the capital. If the first is followed, a group of people wishing to form a company meet before a notary and subscribe the capital, paying in the quota prescribed by law. The capital can also be made up in two steps: (1) the "founders" publish a plan drawn up before a notary, collect associates, call a meeting of subscribers, and (2) then only, also before a notary, the by-laws are discussed and adopted, and the capital subscribed and paid in, in full or in part. This second action creates the corporation. For the last ten years, this method of formation in two steps has been gradually abandoned in practice.

Simultaneous and Successive Formation. There is a fundamental difference between the simultaneous and the successive formation; in the second case it is not necessary for the founders to possess the capital; they need only assemble stockholders. Their interests are therefore less. In simultaneous formation, the founders must subscribe the entire capital. So, in practice, except for small businesses, the banks subscribe, and later place among their customers or on the Stock Exchange the shares that they have thus acquired. These sales can be made at the counters of the banks, according to the wishes of the customers, or else the bank announces the sale by subscription of the shares which it has bought outright; the subscription is closed in a few days and the apportionment is then effected. The bank's profit is derived from the difference between the nominal value of the stock and the rate at which it is issued. The securities can also be traded on the Stock Exchange by the issuing bank. To do this, the authorization of the Commission of the Stock Exchange must first be obtained, and a prospectus published containing a certain number of statements required by law, such as:

[3] A bill has quite recently been deposited on the desk of the Chamber of Representatives providing for new legislation creating a new sort of company "societé familiale" analagous to the British Private Companies, the French *Sociétés à responsabilité limitée* and the German *Gesellschaft mit beschränkter Haftung.*

(1) the dates of all estate transactions affecting the company;
(2) the purpose of the company, its capital and the number of shares;
(3) The amount of unpaid capital and the sum remaining to be paid on each share;
(4) the composition of the executive and supervisory boards;
(5) the specification of the shares in kind and the transfers of real estate by mortgage;
(6) the last balance sheet and the last accounting of profits and losses if they have been published.

In each case, the total capital of a corporation must be *subscribed* on its formation; a fifth of the amount of each share must be paid. The issue of stock to the public is only a second act that is in a way guaranteed by the first. In practice, the stock put into circulation is fully paid. The Belgian law does not set any limit as to the amount of the shares.

It will be understood that the paying up of the securities in kind (shares paid up otherwise than on a cash basis) leads to the worst abuses: overestimation of shares resulting in the "watering" of the capital, excessive remuneration for technical advice, negotiations, etc. That is why the Belgian law requires the published description of the shares in kind. In addition the shares issued as having been fully paid up otherwise than on a cash basis can be traded on the Stock Exchange only after the publication of the second balance sheet of the company. They can always be negotiated by private purchase, according to the stipulations of civil law, but this practice is not common and would arouse suspicion.

The shares not fully paid up, representing new subscriptions, must also remain *personal* (non-negotiable) until completely paid up. The fully paid shares, unless the contrary is provided in the by-laws, may be either personal or transferable.

There are several categories of stock; the terminology in this field is essentially arbitrary and vague, and its interpretation varies with different authorities. The law is silent on the subject.

Preferred Stock. In view of the important rôle played by preferred stock on the financial markets of Anglo-Saxon countries, it is fitting to say a few words on the subject of this class of

stock as it exists in Belgium. It can be created in the two following cases:

(1) If a corporation, the affairs of which are not very prosperous, needs to increase its capital, its directors — in order to induce new capitalists to invest in the enterprise — may issue the new capital as "preferred stock" which shall receive dividends before the original stock.

(2) If a corporation finds it impossible to redeem a bond issue, it may endeavor to induce the holders to accept the conversion of their bonds into preferred stock. This constitutes the exchange of a claim security for an ownership security, with the risks that it involves.

Deferred Stock. Deferred stock is a security representing stock the nominal value of which has been repaid: the capital of a corporation represented by a given number of shares must remain unmodified unless a decision of the stockholders decides its increase or reduction. But a corporation exploiting precarious concessions, for which the equipment will make a return to the granting power after a certain delay, gradually redeems a number of shares through the profits realized. Since the law forbids the repurchase of stock and requires the maintenance of the fixed number of shares, a corporation proceeds simply to *redeem* the common stock which is transformed into deferred stock entitling the holder to vote in the meetings and to receive a certain dividend.

Founders' Shares. Founders' shares or dividend shares are securities awarded gratuitously to the founders of the organization in addition to the common stock, in remuneration for their efforts in forming the company. Generally, one founder's share is distributed for 5, 10, 20, 100, etc. common shares.

In theory, the founders have tied up their capital. To obtain a large return from it, proportional to the risk incurred, they would have to hold their stock for a certain number of years. Now we have seen that in practice the founders are bankers, for whom long-term contingent investments are often impossible. As they must realize in a short time on the securities of an organization that has not yet proven itself, they cannot benefit from high rates; so, in order to be repaid, they award themselves a certain number of founders' shares without designation of value,

but sharing in the profits, in order eventually to receive large dividends. In practice, these founders' shares are put on the stock market, often at very high rates, depending on the way the dividends are apportioned among the different categories of stock. The founder's share, in reality, divides the dividend into two parts, the one awarded to that share being a sort of superdividend.

Voting Power. Voting power is generally attached to each share. The votes must be cast according to the classification of the stocks. Since the inflation, the board of several companies feared that the shares may be bought by foreign groups who would get the control of the business. They have devised various means by which a plural vote is attached to a definite category of shares. For instance, the Société Générale has ruled that "nominative shares" would, on certain conditions, carry ten votes instead of one. Those cases are not many. The balance sheet of the corporations must be published annually and the general stockholders' assembly assumes the power and responsibility of the board of directors (the executive power) and the board of commissioners (intrusted with a supervisory function).

Increases of capital are effected by a legal act, and they must be voted by a majority of the stockholders. The total amount of the new capital must be subscribed and a fifth of each share paid. The issue to the public is accomplished in the same way as when a corporation is formed. If the organization is prosperous, the new stock will be issued at a rate higher than its nominal value, the profit from the issue must be put in the surplus. No issue of stock can be made below par.

Bonds. While the stock represents a share in the ownership of an organization, the bond represents a loan made to the latter by the public, a claim of the holder on the assets of the borrowing company. The bondholder has only an extremely limited power of control. He does not share the losses but he has the right of receiving only a fixed dividend, whatever profits may be realized by the organization. It is natural that the regulations relating to stock should not apply to bonds: thus, a bond loan does not have to be subscribed as soon as it is decided on; the company can issue the bonds according to its financial needs. Generally, however, it tries to place the bonds in blocks, and deals through the intermediary of banks or brokers, or both. Nevertheless, the

regulations for the publication of the acts are the same for stocks and bonds; the prospectus of a bond issue must state, in addition, the mortgages encumbering the company's property.

In Belgium, there is usually only one class of bonds without special guarantees. At the time of liquidation, bondholders share in the division of the company's assets before the owner-stockholders. On account of the disinclination of the public for securities with a fixed revenue, owing to the depreciation of the franc, certain companies have issued, since the war, bonds giving title, in addition to their fixed remuneration, to the share in the profits. There are mortgage bonds to which certain real estate collateral is attached by mortgage deed, generally drawn up in favor of a bank acting as "trustee" of the bondholders.

The issue of bonds which, when for a short term or issued in very large notes, bear the name of treasury bonds, is evidently the best means for the State, communes and local governments to procure resources to meet deficits or to undertake unusual enterprises. The State, when it borrows on short term for the needs of its Treasury, can issue to the public Treasury Bonds of varying maturity.

The Stock Exchange. Such are the securities negotiable on the Stock Exchange or among individuals, in current use in Belgium. The Stock Exchange of Brussels is a very active market for capital. Spot deals and time deals are negotiated there. The absence of precise legislation on the subject of stock exchanges and the brokers frequenting them is a cause of abuse: The Brussels Stock Exchange numbers at present two thousand brokers, who, by the publication of small financial papers, contribute in developing a taste for speculation in the modest middle classes. The important firms of brokers and the banks would like a severe regulation of the profession: security, joint responsibility of the agents, etc. Nothing has been done yet in this direction. A movement in favor of preventive legislation is perceptible, however, and the creation of a clearing house for dealings of the Stock Exchange in public securities has been quite recently initiated by a group of prominent brokers, with the help of the National Bank of Belgium. The daily average of spot transactions dealt with by said clearing house amounts now to 250 million francs.

Since 1898, a "Belgian Association for the Protection of the Holders of Government Securities" has existed in Belgium to look after the interests of the holders of securities of suspended public and private loans.

THE BANK OF ISSUE

The organization of a nation's credit depends on the more or less perfect functioning of its system of fiduciary circulation: if the latter is flexible and elastic, payments by check will be less developed than if, on the contrary, the note issue is rigid, independent of the demands of commerce, and strictly subjected to the gold reserve. Therefore France, a rich country making important investments abroad, but whose central bank has a very flexible circulation, has not greatly developed systems of transfer and clearing.

On the other hand, England, rich, active, possessing the world's foremost foreign portfolio, but having a rigid circulation, has developed to a considerable extent payments by transfers and clearing. Her banking organization, however, is criticized at present by many British bankers, who seem to have been converted to the Federal Reserve System.

To render the following study of the Belgian banking system easier, we shall therefore begin by studying the circulation system and the central bank of Belgium.

Origin of National Bank. Considered excellent from its origin (1850), this system would be extremely interesting examined in detail from a critical and historical viewpoint.

"It was only after experiments for twenty years with existing institutions, which did not operate satisfactorily as banks of issue nor agents of the Treasury, that the National Bank was created in 1850. So directly and effectively has it arrived at these results that it became the model of at least two foreign countries in the reconstruction of their banking system. . . . The subjects of Banking theory and practice have been more thoroughly discussed in Belgium than in some other countries, because each renewal of the charter of the National Bank has been for nearly thirty years. This has led perhaps to a more thor-

ough examination of the question involved than where charters run for shorter terms and proposals for renewal fall more within the channels of routine." (Conant) And, in fact, the National Bank of Belgium has served as a model for the reorganization of the banks of issue of the Netherlands, Jugoslavia and Japan; Count Matsuga, Minister of Finance of the latter country, expressly declared in 1882: "In point of the perfectness of organization and the well regulated condition of business management, the National Bank of Belgium stands highest. This fact is due doubtless to the lateness of its founding, which enables it to consider fully the mistakes as well as the successes of older banks. Its regulations are for this reason more perfect than those of any others, winning highest praises from the financiers of the world." (Conant)

We shall have to limit ourselves, however, to a very brief study of the present charter of the central bank, making a few comparisons with the prewar situation. Those readers who are more particularly interested in the question of the note issue will find in Conant an historical discussion that will refer them to the legal texts and parliamentary documents.

Note Issue. There is only one central institution of issue in Belgium. It bears the name of "National Bank of Belgium," a corporation of which the capital of 200 million francs has been brought in by private shares. The State owns no part. The National Bank has the legal privilege of issuing notes payable to the bearer; this privilege has been transformed by circumstances into a real *de facto* monopoly; indeed, the different organic laws that in 1850, 1872, 1900 and 1926 have established or renewed its charter, have always stipulated that "no bank of circulation can be established on shares, except by means of a special law." The government is therefore always virtually in a position to create a competitor for the Bank, but it is understood that only extremely grave circumstances could bring it to take this step. The private bankers and partnerships with unlimited liability could issue notes, in competition with the National Bank, but the public would not accept them. In addition, only the notes of the National Bank of Belgium are legal tender, which differentiates them completely in the eyes of the bearers from any other paper that might be put into circulation.

" The Bank must have a reserve in gold, or foreign exchange convertible into gold, equal to at least 40% of the amount of its sight obligations, a minimum of 30% of which must be in gold."

FOREIGN EXCHANGE PORTFOLIO. Before the war, the ratio of the reserve to the notes in circulation was determined by the statutes: this proportion could not be less than a third of the sight obligations. It could, however, in exceptional circumstances, go below this minimum with the authorization of the Minister of Finance. For many years, the Bank had built up an important foreign exchange portfolio which it used to protect its metal reserve. To a certain extent, this foreign exchange portfolio allowed the Bank to make up for the inertia of the private banks in the matter of export credits: " The National Bank, by discounting paper drawn by the natives on the exterior compensates, to a certain extent, for the absence of Belgian banks abroad. It was conspicuous several years ago that in order to facilitate the international economic relations of Belgium, it developed as liberally as possible the buying and selling of foreign securities. . . .

" The facilities that the National Bank offered our export commerce were not sufficiently appreciated in Belgium: Antwerp alone went ahead vigorously, but the provinces did not seem to suspect the advantages they had in negotiating their foreign drafts and checks, however small, at the agencies." (Van Elewyck)

As a general rule, the Bank's total reserve, gold and exchange, reached 40 or 45% of the circulation, thus surpassing the legal minimum. It should be added that the gold reserve, properly speaking, was rather weak, partly on account of the peculiar situation of Belgium within the Latin Union.

COMPETITION WITH PRIVATE BANKS. Although it fulfills that function, the National Bank of Belgium is not only the bank of the banks; it enjoys complete liberty to carry on discount and loan operations with private customers and can thereby have a modified effect on the money market, by ultimately restraining the avidity of the private banks. It is fitting to point out here an interesting peculiarity of its method of dealing in discounts; the paper admitted to its portfolio should, according to law, bear three signatures, one of which can be replaced, in certain cases, by collateral in the form of securities or merchandise. This third

signature is furnished by groups of private individuals formed into partnerships with unlimited liability called "discount bureaus" that deal with the Bank's provincial agencies.

Discount Bureaus. "Under the name of *comptoirs d'escompte* (discount bureaus) associations of persons (a private partnership with unlimited liability) are permitted by the general council to discount such paper as is specified by the regulations of the Bank at rates and under conditions prescribed by the general council. The paper admitted by the *comptoirs* is endorsed to the Bank direct. Each *comptoir* is held responsible; so that bad paper is returned to the bureau from which it emanated and which has to make good the amount. The individuals associated in the *comptoir* receive a commission on paper that they discount, to remunerate them for their trouble, and reward them for the risk they take. The commissions are determined by special arrangements." (des Essars)

The bureau must furnish surety, and the Bank has at all times the right to suspend or limit its activity. It can accept foreign paper only with the authorization of the Bank, whose agent is present at all its deliberations, 40 to 43% of the negotiations of the National Bank of Belgium are carried on through the intermediary of the bureaus, and from 57 to 60% are negotiated directly by the Brussels office and the Antwerp branch.

Operation of National Bank. The Bank's operations consist of:

(1) discounting or buying bills of exchange and other paper having commercial transactions as an object and Treasury Bonds within the limits determined by the statutes. From the commercial point of view that is its principal function.

Article 21 of the statutes stipulates that it cannot have in its portfolio discount Treasury Bonds for more than 100 million francs (not including, obviously, the balance of the bonds representing the debt contracted by the State to the Bank at the time of the withdrawal of the marks).

The following are considered commercial transactions for the application of this privilege: purchases or sales made by farmers or to the latter, of cattle, agricultural material, fertilizer, seed, crops and in general, merchandise and commodities relating to the practice of their industry. This is a concession to the farm-

ers, but as a matter of fact, its consequence is limited. (See Section II, Agricultural Drafts). The discounted paper cannot run more than a hundred days.

(2) Rediscounting abroad the paper in its portfolio; to place this paper again as collateral; to guarantee the payment of this paper or of the discount operations and advances relative to it; to acquire assets or obtain credits abroad. This permits it to perform its mission of regulating the exchange and to coöperate with the central banks of other countries.

(3) Carrying on commerce in gold and silver.

(4) Making advances of funds on ingots or gold and silver coins; this arrangement was made in view of the refining operations of the precious metals.

(5) Taking charge of the collection of bills turned over to it by individuals or organizations; this charge is very onerous for the National Bank which has a vast banking network; for localities in which there are no branch banks, the collection is accomplished by the agency of the Postal Service.

(6) Receiving deposits on current accounts (not yielding interest) and, for safe deposit, securities, precious metals, and gold and silver coins.

(7) Lastly, making advances on current account or short term on the deposit of national public securities or other credits guaranteed by the State and the Colony, as well as on similar credits of the Grand Duchy of Luxembourg.[4]

The Bank also participates very actively in the establishment of clearing houses. It keeps the balances of the associates and places its officers at the disposition of the member bankers, both in Brussels and in the provinces.

Relation of State to Bank. The State controls in several ways the operations of the National Bank of Belgium. In the first place, it establishes its charter by legislation; Belgian corporations, according to general law, can be established freely as long as they respect the organic laws in regard to organizations. The State reserves the right of suspending at any moment the

[4] The Grand Duchy of Luxembourg is a little independent territory, extremely industrial (blast furnaces, iron mines), belonging to the Steel Kartell, and which has concluded a customs and economic Union with Belgium in 1922.

execution of all decisions that would be contrary to law, the by-laws or national interests. It appoints a commissioner to supervise all its operations.

The Bank performs gratuitously the service of fiscal agent to the State in accordance with conditions determined by law. The available funds of the Treasury exceeding current needs are invested by the Bank in commercial credits; the Bank is surety for the credits acquired or entered to the account of the Treasury.

The Governor of the Bank is appointed by the King for five years; he can be reappointed; the provincial agents are also appointed by the King in their capacity as fiscal agents of the State.

The government, in agreement with the Bank, determines the form of the bank notes, the way in which they are issued, and their quantity for each classification. The Bank must make weekly reports of its condition.

Compensation to State. In remuneration for the exceptional privilege of issue that it grants the Bank, the government collects, by virtue of different rights, certain sums of varying importance:

(a) Each time a type of bank note is replaced or suppressed, the Bank pays the Treasury on the expiration of a period of time fixed in each case by special agreement, the value of the notes of this type that have not been presented for redemption.

The notes of which the equivalent has been paid to the Treasury are deducted from the amount of the issue; those notes that are presented later at the counters of the Bank are redeemed for the account of the Treasury.

(b) The profit resulting to the Bank from the difference between the rate of $3\frac{1}{2}\%$ and the rate actually collected on its operations is given to the State.

(c) After the deduction of 6% of the amount of the capital in favor of the stockholders, and the payment of 10% to the surplus, and of 6% (of the net profit) to the staff, the State collects three-fifths of the remaining profits.

(d) The Bank pays the stamp duty on the notes in circulation, and does not benefit by any exemption from taxes or duties fixed by common law.

Formerly there was a tax on the average amount of the circulation surpassing 275 million francs; it has been abolished, as well as a duty paid by the Bank to defray the expenses of the Treas-

ury in the provinces; but the share of the State in the profits has been increased, in accordance with the custom prevailing, moreover, in respect to all institutions of issue.

In addition, the Bank serves the Caisse d'Epargne Postale (Postal Savings Bank) gratuitously, and to facilitate the transfer of funds, issues drafts which can be accepted as credits, and which are payable on demand in a few days.

Governance of Bank. The Bank is directed by a Directive Board composed of the governor and three directors, administered by a board of regents and supervised by a council of censors. One of the directors is appointed by the King to replace the governor when absent; he has the title of vice-governor. The law establishes rigid distinctions between the legislative mandates and the mandates emanating from the Bank's boards. The three directors, the nine regents and the ten censors are appointed by the general assembly of the stockholders. Three regents and three censors are chosen from a double list of candidates presented by the Superior Councils of Industry and Commerce, Trades and Merchandising, Agriculture and Labor.

The National Bank of Belgium is thus a private establishment of issue over which the State possesses an important share of control which, however, it has not abused. The note circulation is regulated by the Banking Principle. Its statutes are sufficiently elastic to permit it to intervene effectively on the money market; it is legally authorized to pursue a foreign exchange policy extremely favorable to the stability of the exchange. The formation of the foreign portfolio is an activity of the Bank of which the efficacy was demonstrated during the War of 1870 at the time of the payment of the French indemnity to Germany; at this time, the National Bank of Belgium played an important rôle, in which it acquitted itself with honor.

It is regrettable that it does not have, like the Federal Reserve Banks of the United States, a more direct control over banks resorting to rediscount; the extremely individualistic and empiric nature of the Belgian resents all authority, all supervision, however nominal it may be, and does not believe as yet in the value of commercial and industrial discipline established on scientific bases.

Balance Sheet Changes. The development of the National

Bank of Belgium since the war makes it possible to follow the modifications that have developed on the money market in Belgium in fifty years. Also, it is possible, from the example of our central bank, to draw certain conclusions as to the condition of credit in a state that has suffered the evils of inflation for more than twelve years.

On December 31 of each year, the liabilities of the National Bank of Belgium were divided as below: (in 1000 francs)

Year	Notes in circulation	Current Accounts	Total sight liabilities
1913	1,067,407	117,098	1,184,505
1918	3,210,473	582,669	3,793,142
1919	4,785,916	2,481,695	7,267,611
1920	6,260,495	1,159,316	7,419,811
1921	6,415,054	667,096	7,082,150
1922	6,876,392	456,796	7,333,188
1923	7,537,191	430,257	7,967,448
1924	7,873,124	437,669	8,310,793
1925	7,813,492	459,493	8,273,185
1926 [5]	9,431,715	1,044,929	10,476,644
1927 [6] [7]	9,115,320	731,984	9,847,304

At the same time, the cover for the liabilities suffered the following modifications: (in 1000 francs)

Year	Gold	Foreign Drafts and Assets	Silver	Total
1913	249,027	166,625	56,367	472,019
1918	264,870	100,691	24,850	390,411
1919	266,407	56,885	27,108	350,400
1920	266,520	27,168	27,885	321,573
1921	266,585	20,039	40,566	327,190
1922	268,917	17,376	55,041	341,334
1923	270,487	18,208	75,099	363,794
1924	272,243	30,016	74,037	376,296
1925	273,863	30,223	90,515	394,601
October 25, 1926	273,978	30,223	84,824	389,025
February 24, 1927	3,122,276	2,126,338	—	5,248,614

Except for the last period, which felt the influence of the monetary reform and the reëstablishment of the reserve (see Section

[5] October 25. The accounts of the financial year 1926 were closed on the date of the monetary reform.

[6] February 24.

[7] In this last figure are not included the bank notes of five and twenty francs, withdrawn by the Treasury, amounting to a total of about 702 millions.

II), the ratio between the sight liabilities and the reserve was greatly weakened as a result of circumstances independent of the Bank's control: the inflation of 5,800,000,000 francs to permit the State to withdraw a part of the marks left in circulation by the occupation — the increase during the war of the fiduciary circulation. Let us add that forced legal tender had sway from the declaration of the war in 1914 until October 26, 1926. The foreign portfolio included in the reserve was greatly reduced immediately after the war, but since the beginning of 1926, the Bank has been active again and is striving energetically to build it up. October 21, 1926, on the eve of stabilization, the reserve of the National Bank of Belgium was composed of the following items:

Gold	Gold francs 273,867,000
Silver, copper and miscellaneous	Gold francs 84,236,000
Foreign Drafts and Assets	Gold francs 30,223,000
Total	Gold francs 388,326,000

It is fitting to remark that later the stabilization led to a revaluing of the reserve, but independently of this accounting operation, the Bank had already bought foreign exchange for important sums by means of its own resources.

In relation to the sight liabilities, the reserve rose at that date to 3.82% and the metal reserve to 3.52%. On March 3, 1927, after the stabilization operations, the total reserve (gold and exchange) reached 53.33% of the sight liabilities.

It is interesting to analyze the movement of the Bank's productive operations.

Year (Dec. 31)	Commercial Portfolio	Advances on Public Securities	Total
	(in millions of francs)		
1913	517	61	578
1918	311	84	395
1919	392	63	455
1920	861	161	1,022
1921	458	208	666
1922	713	275	988
1923	1,210	355	1,565
1924	1,553	584	2,137
1925	1,254	898	2,152
1926	1,951	291	2,242

In proportion to the issues the ratio was established as follows:

Year	Ratio in % of the discount operations to the amount of the notes in circulation	Ratio in % of the productive operations to the sight liabilities
1913	48.4	48.8
1918	9.7	10.4
1919	8.2	6.3
1920	13.7	13.8
1921	7.1	9.4
1922	10.4	13.5
1923	16.1	19.6
1924	19.7	25.7
1925	16.–	26.–
1926	20.7	21.4

Effect of Inflation on the Portfolio. This example confirms the rule of inflation: the abundance of media of payment, until prices are readjusted, increases the working funds of merchants and manufacturers, who can finance their businesses much more easily than before. It is only later that the readjustment of prices reëstablishes the normal proportion between the real media of payment and the real needs. In order that the reader can comprehend this striking disproportion, we have drawn up in a single table the movement of the commercial portfolio and that of the fiduciary circulation in comparison with 1913 (=100)

Year [8]	Ratio in % of the commercial portfolio since 1918 to that of December 31, 1913	Ratio in % of the amount of notes in circulation since 1918 to that of December 31, 1913
1913	100.	100.
1918	60.2	300.8
1919	75.8	448.4
1920	166.6	586.5
1921	88.6	601.
1922	137.9	644.2
1923	234.	706.1
1924	300.4	737.6
1925	242.6	732.
1926	377.4	883.6

Professor Chlepner describes as follows this phenomenon which was manifest in the commercial banks as well as in the central Bank:

[8] The valuation of the different items of the portfolio in foreign paper and in Belgian paper is almost impossible for technical reasons. A part of the scientific interest is thus taken from it on account of this fact. We warn the reader in order to avoid possible errors.

"In the first place, one is struck by the slight increase in the commercial portfolio. From 1913 to 1924 it did not even increase in the proportion of one to two and a half (for the commercial banks)."

The increase is much larger if 1918 is taken for the first term of comparison instead of 1913. But the end of 1918 is a wholly abnormal time; during the war the merchants had liquidated all their stocks and repaid their debts. In addition, the abundance of available funds, the scarcity of commodities and the economic stability had caused all credit sales to disappear; everything was paid for in cash.

"With the rebirth of economic activity, the practice of discount was also resumed, but within very narrow limits. We observe, in fact, that at the end of 1920 the commercial portfolio of the commercial banks was not double what it was before the war, although prices had, at that time, almost quadrupled."

The decrease in discount operations is particularly notable if we study the movement of the amount of Belgian paper presented for discount: reduced in 1920 to a tenth of the figure for 1913, the amount of paper discounted has risen to a quarter of what it was in 1913, proof that a number of transactions were negotiated in cash or financed by other credit procedures; for it would be useless to believe that the deposit banks have drawn away the customers of the institution of issue; their "commercial portfolio" item is also considerably reduced, as we shall see. They granted more advances on current accounts, but the classic method of obtaining credit has undergone a profound evolution, and it will take a long time to reëstablish the former practices.

Discounts of the Banks. Total number of commercial bills presented for discount at the National Bank of Belgium:

1913	4,622,788
1920	540,423
1921	496,199
1922	607,445
1923	784,311
1924	1,042,153
1925	1,077,795
1926	1,213,511

The average maturity and the average amount of the discount paper also shows modifications in the discounting practices of the

Bank's customers; the average maturity has increased by about a third: 61 days instead of 45 days for accepted bills and 54 days instead of 45 for non-accepted bills.

Year	Index-number of		Average retail price gold francs	Accepted paper		Non-accepted paper	
	Wholesale prices (in Dec.)	Retail prices (in Dec.)		Average amount in paper francs	Average amount in gold francs	Average amount in paper francs	Average amount in gold francs
1913	100	100	100	3,209.02	3,209.02	367.12	367.12
1920	...	468	171	15,399.95	5,795.66	4,013.22	1,510.35
1921	369	393	154	12,816.24	4,940.99	4,122.75	1,589.43
1922	407	384	147	12,575.26	4,948.58	2,407.81	947.51
1923	545	470	115	12,871.45	3,443.92	3,203.84	857.23
1924	566	521	119	13,795.37	3,281.39	3,623.96	862.—
1925	565	534	127	12,747.07	3,135.89	2,281.40	561.24
1926	860	741	100	14,698.71	2,384.52	2,478.61	402.10

In a general way, the average amount of commercial paper has been directly affected by the increase in the cost of living.

COMMERCIAL AND INDUSTRIAL BANKS AND FINANCIAL TRUSTS

Legal Status of the Belgian Private Banks. For an understanding of the analysis that is to follow, it is useful to obtain a notion of the legal status of the Belgian banks.

The great majority of them have been established in the form of companies with shares and, in fact, the only laws regulating them are those referring to corporations.

As may be inferred from the fact that these laws deal with the entire group of economic organizations established as corporations, they do not make any special stipulations in regard to banks, which, contrary to the practice in other countries, are not subject to any special legislation. Practice has, it is true, somewhat enlarged the meaning of the legal provisions and, *proprio motu,* most of the banks have interpreted very liberally Article 76, which stipulates that:

"Fifteen days before the general assembly, the stockholders can inform themselves at the head office:

("1) of the balance sheet and the account of the profits and losses,

("2) of the list of public securities, stocks, bonds and other securities of companies forming the portfolio,

("3) of the list of stockholders who have not paid up their shares with the indication of the number of their shares and their addresses,

("4) of the report of the commissioners.

"The balance sheet and the account, as well as the report of the commissioners is sent to the stockholders in name at the same time as the notice of the assembly.

"Every stockholder has the right to obtain gratuitously, on producing his certificate, fifteen days before the assembly, a copy of the documents mentioned in the preceding paragraph."

Degree of Control by the Central Bank. As a matter of fact, most of the banks publish spontaneously as a supplement to their report, which rarely has a general economic interest, a list of the securities forming their portfolios. Only two banks publish their monthly condition regularly.

One might think that the central institution of issue, as in the United States, for instance, exercises a legal and effective control over the activity of the commercial banks. It does nothing of the sort. Since 1850, none of the laws regulating the status of the institution of issue has bestowed control of credit establishments upon the central bank, which is reduced to simple empiric supervision, the occasion for which is furnished by rediscounting. Let us hasten to add that the Bank of issue succeeds, nevertheless, in exercising a control in this way that is often effective, but that is deprived of all legal sanction and scientific basis.

Establishment of Banks. The establishment of banks is absolutely free, so long as the founders respect the general laws on commercial organizations. We have seen in the course of our rapid analysis of the charter of the Bank of issue that it enjoys a *de facto* monopoly of the issue of bank notes. The absence of special legal provisions relating to banks is such that even the branches of foreign banks have no other statutes than Section XI of the coördinated laws, which subjects foreign companies to con-

ditions analogous to those imposed on Belgian organizations. Now, companies have to publish only a general, world balance sheet, without distinguishing between the different offices, and the branches of foreign organizations established in Belgium can preserve the most profound secrecy in regard to their operations. It will be easily understood that the balance sheet of the National City Bank of New York, for example, has no significance from the point of view of the activity of its branch in Brussels.

The bank of issue may grant foreign banks advances on public securities and, in principle, may accept paper from them for rediscount, although the Belgian branches of the large foreign banks generally avoid resorting to it.

There is another extremely characteristic feature of our financial legislation on which it is pertinent to dwell: that is the liberty enjoyed by the stock exchange brokers, who, however, frequently play the rôle of " promoters " in the forming of corporations, and who do not restrict themselves to their mission as agents as in France and Great Britain. This is the place to quote Professor Chlepner: " It is known that the professions of banker and stock broker are with us subject to no conditions. Now, if this situation seems to us inadmissible for the banker, who at least is working for himself, it is to be totally condemned for the stock broker, who, in principle, is the representative of his customer . . . and who should present strong guarantees of his probity.

" It is true that if the practice of the profession of stock broker is free, admittance to the Stock Exchange is subject to certain conditions, but this system was introduced only in 1914, without retroactive effect. Therefore there are even among the stock brokers who are admitted too many doubtful elements." And also, it is due only to the fact that Article 61 of the Code of Commerce confers on the communal authorities the control of the commercial stock exchanges and securities that it is possible to regulate the profession; the laws of December 30, 1867 and June 11, 1883 are silent on the subject of the conditions to be fulfilled in order to practice the profession of stock broker.

The extreme liberty of which the legislator has not seen fit to deprive private persons and organizations concerned to any degree whatever with money commerce influences the speculative

character of certain Belgian banks, that, however, generally enjoy a rather strong situation, but, at the same time, it reduces to a minimum the documents on which a methodical and logical study of our banking system can depend, and perhaps we may attribute to this cause the extraordinary absence of research on the subject, if certain works on the institution of issue are excepted.

The daily press and the financial press do not appear either to be greatly interested in the scientific aspects of the development of the financial organization in Belgium. They are satisfied to publish official communications, balance sheets, and corporation reports.

Official statistics are extremely rudimentary in Belgium from the economic, banking and financial standpoints. No important statistics on the money and capital market were published until two years ago.

General Banking Situation before 1914. From the economic point of view, the Belgian banks before the war were characterized by the preponderance of those established in the capitol, by the absence of concentration and their individualism, by the mixed character of their operations and the " confusion of functions." " The dominant trait of the Belgian banking system consists of the constant relations of the bank to industry; most of the Belgian banks are not satisfied with short-term commercial credit; in addition, they grant advances liberally to their customers on current accounts. Besides, many of them, especially the most important, participate in the formation of industrial companies by subscribing to their securities. They share also in increases of capital, bond issues, etc. They are represented on the board of directors of the industrial companies and preserve a permanent contact with their customers. In short, the Belgian banks in general belong to the type of the mixed bank." (Chlepner)

The financial predominance of Brussels is explained by its central situation, by the fact that no city in the Kingdom is farther than two hundred kilometers from it, and that the capitol is the center of an excellent road and railway system, in a country of 30,000 square kilometers and 7,600,000 inhabitants. This predominance of Brussels gets more and more important, because

the great banks of this city monopolize all the financial transactions, and leave the regional commercial ones to the provincial banks. Antwerp, however, is still playing an important part in the formation of companies. The rôle played by Brussels' banks is the more easily explained when one considers that the southern part of Belgium is superindustrialized and needs capital it cannot find on the spot. On the other hand, the northern part is quickly awakening to capitalism and industry and requires also financial leadership.

Financing Associations. The enumeration of the characteristic features of banking structure in Belgium would not be complete if we neglected to mention the financing associations (*investment trusts, financial trusts*) that give powerful assistance to the expansion of Belgian capital and industry outside of the country, and which are, for the most part, offshoots of the banks. This expansion is characterized by the fact that we possessed only an insignificant number of bank branches abroad, and, in order to place their manufactures, the metallic, construction, and electric industries had created outside of the frontiers, in Italy, Spain, South America and the Orient, Belgian companies for the exploitation of transportation, lighting, etc. Their capital was subscribed in Belgium by the banks and financing associations, and their financial service was carried on in Belgium by the parent banks. Very real and active, Belgian expansion took an industrial rather than a commercial or banking form, which led to the Belgians being frequently reproached with not turning their attention to foreign countries. "During the four years from 1910 to 1913 the issues of Belgian companies operating principally abroad rested on a capital of 1,672 million gold francs." If certain years are taken, it is seen that the issues of Belgian companies having their principal field of activity abroad, consisted of the following:

	Number	(in thousands of francs) Capital
1890	29	69,383
1900	188	459,419
1910	161	420,315
1911	164	530,712
1912	173	591,520
1913	173	452,335
Total	888	2,523,684

We shall try to present a general view of the present situation, as it appears from a study of the documents at our disposal.

THE MOVEMENT TOWARD BANKING CONCENTRATION. Concentration is a natural tendency of contemporary organization and the German, French and English banks had succumbed to it before the war, each by different methods: investment control, increases of capital, consolidation, and the creation of agencies.

In Belgium, the case was far from being the same. Few banks spread beyond the city of their head office; in fact, the Société Générale de Belgique alone had grouped about it a chain of dependent banks or banks that it supported. It owed this entirely peculiar situation to the fact that, having played the rôle of fiscal agent to the State from 1830 to 1850, it possessed during that period a network of provincial agencies that later were sometimes formed into autonomous organizations. Alone among the banks of any importance, the Crédit Anversois and the Crédit Général Liégeois had followed a policy of expansion by means of branches.

However, no legal provision placed the least obstacle in the way of the creation of branches, but the individualistic spirit of Belgian manufacturers and merchants was much better adapted to the existence of numerous local banks of moderate importance, which occasionally had a few unimportant agencies in the district. Even private banks sometimes had one or two. In addition, the bank's own resources were generally not very important. This can be seen from the following table, drawn up with the assistance of information taken from the *Moniteur des Intérêts Matériels*.

The notaries and stock brokers also played an important rôle in mortgage loans and issues of securities, either on their own account or as intermediaries of the banks.

The war brought profound changes into this situation that are difficult to discern at first glance; this is, moreover, partly due to the fact that the official statistics are wanting in some respects and present certain contradictions.

Thus, if we refer to the statistics of the movements of commercial organizations published by the Ministry of the Interior, we reach the following conclusions, bearing exclusively on the num-

Size of Capital (in francs)	Number of Banks						
	1913	1920[9]	1921	1922	1923	1924	1925
Under 5 million.......	39	27	35	34	38	36	35
Per cent of the total	*58.2*	*37.5*	*43.7*	*41.–*	*44.7*	*39.1*	*36.5*
Between 5 million and 10 million........	10	19	19	22	20	25	26
Per cent of the total	*14.9*	*26.4*	*23.7*	*26.5*	*23.5*	*27.2*	*27.1*
Between 10 million and 20 million........	10	13	10	9	9	13	14
Per cent of the total	*14.9*	*18.1*	*12.5*	*10.8*	*10.6*	*14.1*	*14.6*
Between 20 million and 50 million........	8	7	10	11	11	8	10
Per cent of the total	*11.9*	*9.7*	*12.5*	*13.3*	*12.9*	*8.7*	*10.4*
More than 50 million..	–	6	6	7	7	10	11
Per cent of the total		*8.3*	*7.5*	*8.4*	*8.2*	*10.9*	*11.5*
Total..............	67	72	80	83	85	92	96

ber of organizations and not at all on the amount of capital invested.

BANKS AND FINANCIAL OPERATIONS
ORGANIZATIONS FORMED

Year	Partnerships with unlimited liability	Partnerships without share issues	Partnerships on shares	Corporations	Coöperatives	Others	Total	Renewals	Liquidations	Increases of capital
1920	48	13	1	39	362	1	464	6	19	53
1921	34	8	1	32	113	..	188	7	34	50
1922	42	12	1	34	70	1	160	5	28	29
1923	64	15	1	36	68	..	184	10	35	35
1924	59	12	..	58	15	..	144	24	41	52
1925	47	9	1	45	21	1	124	11	38	47
Total	294	69	5	244	649	3	1264	63	195	266

The official statistics include under the same heading " banks " and establishments concerned with " financial operations." This confusion is regrettable; it is not possible, according to these figures, to make the necessary differentiations.

[9] For the post-war period, it is evidently necessary to take into account the depreciation of the money, which makes it impossible to consider increases of capital from an absolute point of view.

In addition, in the case of corporations, for which the amount of capital is published, it would have been opportune to make use of this important information.

Interpretation of Statistics of Banks Organized. The statistics cited above give the impression of a sudden cropping up of banks after the Armistice. In reality, this was far from being so, and the number of banks proper increased by only about twenty. The imposing total of 649 coöperatives founded since 1920 is composed for the most part of Savings Banks and the branches of the Boerenbond: this powerful peasant and Catholic coöperative establishes itself in all localities to which it gains access to coöperative dairies, insurance and savings offices, and the multiplication of its activities, in spite of appearances, is an indication of the powerful centralization policy pursued by the Boerenbond. A very small number of coöperative banks and a few companies of stock brokers were also created in the same form. Many of the latter have also adopted the corporate form, and some private bankers as well have given their organizations this legal form. But more critical statistics, which we shall use freely, those published annually by the *Moniteur des Intérêts Matériels,* demonstrate in reality that the founding of banks, properly speaking, has been quite limited. However, the movement towards horizontal concentration has been somewhat hindered by attempts at integration, a group of producers or merchants attempting to subjugate credit to their authority by creating a bank that, in this case, often took the coöperative form. This subjugation of the bank to industry and commerce is characteristic of periods of inflation and monetary depression.

Capital Invested in Banks. Since the Armistice, the following table gives the amount of capital invested in the banks, as well as that invested in the total number of organizations, according to the statistics of the Banque d'Outremer.

As was demonstrated by the statistics of the number of banking enterprises, these of the movement of capital reveal the importance of capital increases, and their preponderance over the simple founding of organizations. Certainly the monetary depreciation played an important part in this movement, and it would be rash to overestimate the part played by tendencies

(in thousands of francs) [10]

Year	Banks			Total number of organizations		
	New issues	Increases	Total	New issues	Increases	Total
1919	168,358	495,945	664,303	977,139	1,200,672	2,177,811
1920	56,576	347,610	404,186	829,412	1,823,739	2,653,151
1921	70,670	275,902	346,572	436,336	1,217,042	1,653,378
1922	30,874	257,965	288,839	413,766	1,207,527	1,621,293
1923	56,808	351,938	408,746	654,953	1,369,969	2,024,922
1924	66,441	408,392	474,833	576,719	2,213,293	2,790,012
1925	150,238	247,545	397,783	918,895	1,482,273	2,401,168
Totals	599,965	2,385,297	2,985,262	4,807,220	10,514,515	15,321,735

toward concentration alone. The considerable importance of the capital absorbed by the banks — nearly a fifth of the total issues — will also be noted.

Detailed Study of Concentration Movement. Armed with these very general facts, it is now possible to advance further and to study the concentration movement in detail.

Before the war, the Banque de Bruxelles was almost isolated. But, since then, it has founded a chain of affiliated banks numbering twenty-one, and the capital of the group has risen from 36,350,000 francs to 160,500,000 francs. Here is a convincing example of concentration. The table on p. 237 is very interesting in this respect.

Consequently, of the 96 banks that the statistics of the *Moniteur des Intérêts Matériels* take into consideration, 35 had a capital of more than ten million francs while, of the 67 banks of 1913, only 18 belonged to the two large groups. The group known as the " Louvain " banks, having at its head the Caisse

[10] Figures for 1926 and 1927 are now available:

Banks (in thousands of francs)

Year	New Issues	Increases	Total
1926	142,549	118,244	270,792
1927	8,450	623,440	637,890

Year	Banks Affiliated with the			
	Banque de Bruxelles		Société Générale de Belgique	
	Number of banks	Capital (francs)	Number of banks	Capital (francs)
1913	4	36,350,000	15	85,300,000
1920	10	76,500,000	16	153,500,000
1921	13	99,500,000	16	160,500,000
1922	16	118,500,000	16	163,500,000
1923	18	128,500,000	16	163,500,000
1924	20	155,500,000	16	256,000,000
1925	21	160,500,000	16	286,000,000

Centrale de Crédit of the Boerenbond, is made up of several banks operating mostly in the Flemish part of the country.

Banking concentration has also adopted another form that is interesting to study: that is the creation of numerous agencies scattered throughout the entire country, and charged, on the one hand, with collecting deposits, and, on the other, of placing issues of public securities among scattered customers.

At the end of June, 1926, the Belgian banking organization included:

103 head offices
200 branch offices
574 agencies
543 bureaus

that is, 1,420 seats of activity, for 7,800,000 inhabitants. The figures for 1913 have not been drawn up: "numerous present agencies were little private banks that have been absorbed and that might themselves have several auxiliary bureaus, which, however, could be enumerated only with great difficulty, owing to their legal status: private enterprises, or partnerships with unlimited liability, not compelled to make legal publications. In any case, taking into account certain facts, notably, the percentage of increases of officers in the group belonging to the Société Générale, the creation of certain large, and entirely new banks, with branches, since the Armistice, and the new tendency of the Banque de Bruxelles, we believe that there could not have been in

1913 more than between 250 and 300 subsidiary offices, the number of main offices being 65."

Belgium contains 2650 communes. That would make about one banking office for two localities; but the big industrial and commercial cities are much better provided: Brussels has 166 offices, Antwerp 94, Ghent 15, Liége 17, Namur 9, Charleroi 13, Tournai 11, Mons 9, Bruges 10, Hasselt 10, and Ostend 10, that is, 375 offices for the eleven most important localities. It is easy to see that the number of banking establishments in a single place is excessive and results from bidding against each other and the competition of the groups.

A more detailed examination of the banking map leads us to even more interesting conclusions. The Franco-Belgian frontier, principally in Flanders and Hainaut, is sown with a string of banks that have often served to receive deposits of French money (see below), particularly at the time of the violent fluctuations of the French franc. Let us add in this respect that several middle sized banks in Brussels also specialize in the management of funds deposited by French customers who are afraid of the fiscal policies of their government and do not care to leave their capital in their own country.

The banks install their agencies in localities that do not always have an agricultural and economic importance corresponding to the number of bank bureaus existing there. This is the result of a campaign to attract the peasants' savings which have been considerable since the war.

Localities	Offices	Number of Inhabitants
Neufchâteau	6	2,578
Virton	4	2,819
Eupen	4	12,276
Hannut	5	2,098
Turnhout	8	23,742
Leuze	5	5,981
Ypres	6	17,409

The recruiting of staffs is difficult, and among the "branch managers" of a bank that failed, having 91 agencies, are found: a teacher-sexton, teachers, brewers, a wheelwright, a baker, a miller, a printer-sexton and an organist-sexton. These people, probably very honorable none the less, were evidently not quali-

fied to fulfill as delicate a mission as that of bank agent, and the multiplication of not very solid bank agencies, easily exposed to a run, is not of a nature to inspire sound confidence in credit establishments in the minds of the people.

Many things remain that could be said on the subject of the concentration of Belgian banks, but we believe we have succeeded in convincing the reader that there has been a real movement for concentration since the war. Certainly it has been masked by attempts at vertical integration, and by the "bubbles" that are formed in periods of prosperity and inflation, but, on the other hand, it appears clearly in the formation of chains, banking systems, and the multiplication of agencies intended to concentrate deposits and lead them to flow into the financial centers of the country, particularly to Antwerp and Brussels.

We shall have an opportunity, however, to return to this topic when making a brief examination of the deposit policy.

General Situation of the Belgian Banks. The analysis of the situation of the total number of Belgian banks is very instructive. To accomplish it, we shall utilize the statistical tables that are published each year by the *Moniteur des Intérêts Matériels*. The table on page 240 presents a summary of these figures.

Strengthening of Reserves. What is striking, first of all, is the strengthening of the reserves; after 1920, they are ten times greater, in round numbers, than before the war, and they have remained at the same level, almost without interruption, until the end of the last year for which we possess the facts. This will appear, certainly, as a proof of the prudence of most of the credit establishments, which have been aware since the Armistice of all the dangerous elements in the post-war financial situation.

We have already called attention to the slight increase in the commercial portfolio of the National Bank of Belgium; the explanation we have given also applies to the commercial portfolios of the private banks. It should also be said that the considerable increase of the years 1925 and 1926 comes from the fact that the statistics have been completed by adding the items of the balance sheet of the Société Nationale de Crédit à l'Industrie. The item that has most increased is that of ordinary current accounts, which best expresses the close relations of the bank with industry.

SITUATION OF THE BELGIAN CREDIT ESTABLISHMENTS ON DECEMBER 31 OF EACH YEAR
(In thousands of francs)

ASSETS

Years	Number of banks	Reserve	Portfolio of commercial paper	Portfolio of securities and investments	Current accounts (including stockholders)	Loans, real estate, etc.	Total assets
1912........	66	130,785	669,505	730,672	1,152,350	792,852	3,477,164
1913........	67	172,365	777,527	717,315	1,410,750	848,634	3,926,591
1920........	72	1,231,428	1,327,278	2,845,149	4,671,278	827,008	10,902,141
1921........	80	1,023,168	1,861,998	3,331,750	4,459,555	863,680	11,540,151
1922........	83	983,558	1,873,393	4,008,852	4,593,387	1,011,708	12,470,898
1923........	85	1,031,567	1,736,054	3,436,826	6,246,285	1,264,536	13,715,268
1924........	92	1,115,778	1,821,288	3,274,904	7,009,147	1,455,499	14,676,616
1925[11]	96	1,353,692	3,120,923	4,234,307	8,566,241	1,482,484	18,763,647
1926[12]	94	2,036,906	3,566,914	4,033,985	9,992,145	1,551,709	21,181,659

LIABILITIES

Years	Paid up capital	Capital to be paid up	Miscellaneous surplus	Obligations		Profits	% profit of the paid up capital	Losses	Total liabilities
				Fixed term	Immediate or undetermined				
1912....	452,490	111,324	221,915	628,934	2,013,839	56,327	10.75	7,665	3,477,164
1913....	496,466	124,230	235,244	673,922	2,334,958	68,230	12.44	6,459	3,926,591
1920....	948,418	189,365	439,845	911,481	8,270,826	140,341	15.75	7,135	10,902,141
1921....	1,059,030	229,837	486,137	1,096,390	8,517,542	157,663	14.28	6,454	11,540,151
1922....	1,178,927	204,794	617,295	1,004,673	9,506,346	169,158	13.88	5,501	12,470,898
1923....	1,227,554	225,156	714,918	1,403,258	10,156,023	219,422	17.39	5,907	13,721,175
1924....	1,471,072	309,889	878,278	2,238,916	9,841,672	279,021	18.60	5,343	14,581,959
1925....	1,663,931	376,415	987,937	4,532,428	11,263,696	325,533	18.97	9,878	18,763,647
1926....	1,684,588	324,367	1,081,924	3,679,924	14,294,565	448,790	26.64	8,332	21,181,659

[1] These tables are published in June of each year following the financial year to which they refer.
[2] During the year 1926 several banks have merged together.

This has increased since the resumption of economic relations in Belgium. In order to rule out the inevitable imperfections of statistics as extensive and elastic as those of the *Moniteur des Intérêts Matériels,* Professor Chlepner has made a table including the principal items of eighteen credit establishments,[13] of which the paid up capital and surplus reached ten millions in 1913.

SITUATION OF THE PRINCIPAL BELGIAN BANKS

(In millions of francs)

Assets	1913	1918	1919	1920	1921	1922	1923	1924
Reserve.........	109	569	935	722	496	503	491	580
Commercial portfolio..........	578	214	702	880	1,287	1,234	1,150	1,151
Current debit accounts........	736	1,039	2,689	2,551	2,426	2,487	3,109	3,053
Stocks and bonds[14]	420	440	554	666	604	673	769	1,050
Government securities[14]......	190	1,017	1,443	1,357	1,466	1,573	·1,444	1.091
Sundry advances	356	371	279	295	267	324	441	553
Real property...	40	40	455	67	83	106	113	133
Liabilities								
Paid up capital and surplus...	545	602	793	925	944	1,154	1,169	1,575
Commitments...	1,806	3,071	5,582	5,586	6,047	6,193	6,170	6,169

[13] Société Générale, Banque de Bruxelles, Banque d'Anvers, Banque d'Outremer, Caisse de Reports, Crédit Général Liégeois, Banque de Reports, Crédit Anversois, Banque Centrale Anversoise, Banque Internationale de Bruxelles, Banque Liégeoise, Crédit Générale de Belgique, Banque de Flandre, Banque Générale Belge, Banque de l'Union Anversoise, Banque de Crédit Commercial, Banque de Gand, Banque Générale de Liége.

In the meantime, the Banque Internationale was absorbed by the Banque de Bruxelles, and the Banque de Reports and the Bank de l'Union Anversoise by the Banque d'Anvers. The totals therefore remain comparable.

We have excluded the Banque Belge pour l'Etranger and the Banque Italo-Belge, of which the balance sheets are too greatly influenced by operations outside the frontiers.

[14] In certain cases, the distinction between the securities of companies and loans of the public powers does not appear sufficiently clear. But the resulting risk of error is extremely slight.

The item "Government securities" is composed mostly of Belgian securi-

In 1918, the debit current accounts showed an increase of 300 millions, there being numerous organizations that were obliged to contract loans during the war on current accounts, in order to pay the salaries of the staff retained on duty, and sometimes even to deal in bonds. In 1919, the sum of this item was larger than 2.5 billions, and did not increase more than by 500 millions up to the end of 1924. It was "for reconstruction work, to build up their stocks again, to increase their working funds — an increase necessary on account of the rise in wages and prices — that manufacturers resorted to their banks. And this in spite of the increase of capital and bond issues to which everybody resorted."

The examination of the item "real property" can occasion little discussion: the estimation of the commercial value of the bank buildings is very difficult, and it is probable that the administrations interested have made it with extreme prudence. If the amount of the item has increased from 40 to 133 millions, it is not on account of revaluation of existing buildings, but rather on account of the extension of provincial agencies installed in buildings of imposing appearance and considerable commercial value.

The Security Portfolio. One observation is necessary at the start: banks' "hidden surpluses" and "hidden profits" realized on their portfolios are commonly spoken of. We believe that this is considerably exaggerated, and that if the banks have not stated in their balance sheets the increase in value of their portfolios, they should be commended for it. It should also be noted that, contrary to the German law, the Belgian law is absolutely silent on the rules that should prevail in valuing securities in the portfolio.

We have submitted the portfolio of one of the strongest Belgian banks to a critical analysis. We have done this as regards the securities quoted on the Stock Exchange. These figure in the balance sheet for the sum of 56,350,775 francs, that is, for

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ties; it includes, however, a certain quantity of foreign securities that it has not been possible to eliminate.

This table does not pretend, moreover, to give an absolutely precise picture of the reality. The balance sheets are often not very clear and the ways of making them up frequently vary, the law stipulating merely that the balance sheet should differentiate between the fixed assets and the available assets, between the debts of the company to itself, to third parties and the claims of others secured by mortgages.

their nominal value. Their Stock Exchange value at the date of the closing of accounts was 184,011,157 francs. The plus-value is then 120 millions, but it must be taken into account that the nominal value of most of these securities is expressed in pre-war francs; if the Stock Exchange rates simply reflected the monetary depreciation, by making the rates rise proportionately, we should see the value of the portfolio reach 395 millions at least, without capitalizing the surplus or the income from the securities. It would even be possible to say that as regards their portfolios constituted in 1914 the banks have suffered a loss in value, if the present rates are translated into gold.[15]

Moreover, the banks make no mystery of the moderate way in which they value their portfolios, and make a merit of not basing them on the Stock Exchange rates. It is also quite evident that a forced liquidation of such important quantities of government securities would lead to considerable depreciation.

However that may be, the security portfolios and investments have risen from 730 millions to 4,234 millions. Now we have seen that the Stock Exchange rates are far from reflecting the monetary situation. We can say, with Professor Chlepner, that "this fact is explained by the numerous increases of the capital of industrial organizations, in which the banks must take shares, without being able to turn the securities over to the public immediately. Also, the desire to increase holdings of real assets has played a certain part."

[15] The following table shows that the Belgian banks could hardly keep up the gold value of their assets (in millions of francs).

Years	Total assets (In paper francs)	Total assets in gold francs (paper francs converted to gold at annual average rate of exchange on New York)
1912	3,365	3,365
1913	3,802	3,802
1920	10,712	4,031
1921	11,310	4,360
1922	12,470	4,907
1923	13,715	3,669
1924	14,676	3,491
1925	18,763	4,616
1926	21,181	3,436

Security Portfolio Policy. A detailed analysis of the security portfolios of the large banks makes it possible to discover the policy they pursue. In a general way it can be said — we are considering only the strong banks here — that the credit establishments divide among each other the companies in which they wish to exercise an influence. This division, obviously, is not premeditated, nor is it absolute; it often results from fortuitous circumstances: propositions addressed to one bank rather than another, personal relationships between the bankers and the industrial captains. Sometimes, but very rarely, a struggle takes place for the control of an enterprise. Often, too, unrelated banks are interested in the same enterprise.

Two facts are worthy of attention in the study of the portfolios of the large banks: the colonial expansion and the making of investments in foreign banks. The majority of the colonial companies have had a bank presiding over their foundations, through the influence of King Leopold II, and the rôle of the Société Générale was very important in this respect.

There are at present about 170 colonial organizations, with a total capital of more than three billion francs. If before the war the general public was scarcely interested in the Colony, its disposition has changed since, and evidently it is only due to its participation that the total amount of the issues of the colonial organizations has succeeded in reaching one billion, four hundred million in capital money between 1919 and 1926. (See table at top of page 245.)

In 1926, the income of the Belgian colonial organizations in the Congo rose to 200 millions, although many of these companies were of only recent foundation and were still in the process of organization.

The movement for expansion of colonial organizations has been considerable, which is perfectly comprehensible since our country expects indispensable assistance from the Belgian Congo in her rehabilitation, and, on the other hand, the development of this immense territory is extremely costly. The banks have established veritable chains of colonial organizations which are interested in each other; they are in touch with the enterprises, and they present many examples of integration and concentration.

If the situation of each bank is analyzed, it is seen that their

Years	New Issues	Increases of capital and Bonds	Total
	(In thousands of francs)		
1919	15,426	14,380	29,806
1920	24,776	56,661	81,437
1921	6,374	16,765	23,139
1922	51,691	173,349	225,040
1923	3,751	56,900	60,651
1924	19,505	150,712	170,217
1925	205,146	162,342	367,488
1926	66,323	407,225	473,548
Total	392,992	1,038,334	1,431,326 [16]

portfolios before the war comprised numerous securities of foreign companies and of financial trusts with fields of activity abroad. The necessity for the banks to coöperate in increasing the capital of national organizations, and international political and monetary difficulties, obliged our credit establishments to pursue a " domestic policy " which took the form of increased portfolio of Belgian securities and of those of Luxembourg as well, as a result of the elimination of German influence in the Grand Duchy of Luxembourg.

The political and economic strength given by the possession of such a portfolio is considerable; however, the banks did not always succeed in utilizing it to the best advantage of national interests, as is disclosed in this confession by one of the directors of the Société Générale:

" It will be permissible to recall that immediately after the Armistice the Société Générale, through its Governor, issued an urgent appeal to the heads of the great metallurgic enterprises, asking them to make an agreement among themselves with a view to the reconstruction of their factories that were, for the most part, entirely destroyed, or partly so. Before the war, their de-

[16] In 1927 the issues of colonial companies developed greatly, as shown by the following figures (in thousands of francs).

Year	New Issues	Increases of Capital	Total
1927	1,034,000	451,000	1,485,000

The total capital invested in private companies since the armistice amounts to 2,916 millions of francs.

velopment had been accomplished with each company considered as an entity completely independent of the others, and hence, each, instead of specializing, tended to perform all the operations of transforming metal. Was it reasonable to rebuild each group of factories by reinstalling in each, at a cost of millions, blast furnaces, steel mills, rolling mills, etc., and would it not be better, on the contrary, to profit by the fact that almost everything had to be done over, and unite all these companies in a vast 'pool,' assigning each group of factories a specialty? . . . the project finally failed on account of the individualistic tendencies of several of those interested."

But the Société Générale succeeded in accomplishing the concentration of the coal industries placed under its protection, and the concentration of the electric enterprises is quite effective. The same is true of the glass-making industry. The government policy tends to favor concentration.

Increased Investments in Foreign Banks. Since the war, the Belgian banks have greatly developed their investments in foreign banks, and they have extended their relations particularly with Central and Eastern Europe (Austria, Czechoslovakia, Poland.) The following table demonstrates this. The reason for this policy seems to be the temporary expulsion of German and Austrian financial influences from these countries, which they formerly dominated. Finally, many of these Balkan and Baltic

BANKING INVESTMENTS OF THE MOST IMPORTANT BELGIAN BANKS IN FOREIGN COUNTRIES

	1913	1920	1925
Luxembourg (Grand Duchy)	–	1	1
France	7	10	7
England	3	1	–
Holland	–	1	–
Germany	–	1	1
Spain	–	–	1
Portugal	–	–	1
Italy	1	1	1
Austria	1	2	3
Poland	–	–	2
Czechoslovakia	–	–	3
Yugoslavia	–	–	1
Roumania	1	1	1
Bulgaria	–	–	1
Lithuania	–	–	1
Dantzig	–	–	1
Total	13	18	25

countries can be considered almost virgin ground from the industrial and commercial points of view, and the Belgian banks count on finding outlets in them for their entire group.

However, taken as a whole, the portfolios of foreign securities held by our banks, and the number of organizations in which they are interested, have been reduced; at the same time the shareholdings in national organizations, principally colonial, have increased. The table on page 248 shows this. However, the depreciation of the franc must be taken into account, as it influenced the banks to share freely in the capital increases of organizations already existing.

The Deposit Policy. It is generally held that banknote inflation, by placing larger quantities of media of payment and saving at the disposition of the public, tends to increase the quantity of deposits, furnishing the banks thereby with new resources for exercising credit on accounts. However, we believe this theory to be admissible only with certain reservations.

In Belgium, in 1913, the circulation was about a third of the amount of the deposits. Later, this proportion was not maintained — far from it: the deposits, to correspond in the same ratio to the circulation, should have risen, in 1924, to 23,619 millions, instead of to 12,053 millions (circulation: 7,843 millions) and, in 1925, to 23,439 millions instead of to 14,807 millions (circulation: 7,813 millions).

Therefore there was a shrinkage of deposits in the banks and other credit institutions, as will be easily seen from the table below.

Year	Banknote circulation	Amount of the liabilities of the banks on shares of the Savings Bank, the Caisse Centrale of the Boerenbond and the Société Nationale de Crédit à l'Industrie		
		Time liabilities (1)	Demand liabilities (2)	Total liabilities (1 & 2)
1913	1,067,407,000	1, 773,156,386	2,375,240,039	4,148,396,425
1920	6,260,495,000	2, 907,994,373	8,451,927,428	11,359,921,801
1921	6,415,054,000	3, 302,044,394	8,739,200,733	12,041,245,127
1922	6,876,391,000	3, 400,309,621	9,761,615,105	13,161,924,726
1923	7,537,191,305	4, 090,840,377	10,452,410,285	14,543,250,662
1924	7,873,123,539	5, 744,084,352	10,165,334,637	15,909,418,989
1925	7,813,691,752	5, 751,282,370	11,630,562,410	17,381,844,780

SUMMARY OF THE SECURITY PORTFOLIOS OF FOUR BELGIAN BANKS [17]

	1913				1920				1925			
	Belgium		Foreign		Belgium		Foreign		Belgium		Foreign	
	No.	Capital	No.	Capital	No.	Capital	No.	Capital	No.	Capital	No.	Capital
Banks......................	49	66,824,450	61	17,142,550	64	107,580,775	19	37,610,040	75	197,791,850	19	52,372,505
Mines and Coal Industry......	25	35,007,100	4	1,551,000	29	53,775,450	3	1,462,625	31	110,862,575	5	5,227,675
Metallurgy and Mechan. Const.	16	14,677,900	6	20,448,880	29	59,956,220	12	29,449,800	35	99,586,500	6	58,580,500
Colonial Organizations........	20	13,014,200	7	2,611,700	35	31,533,565	5	2,868,900	54	78,634,670	5	9,324,300
Tramways — Electricity......	43	18,690,780	10	6,947,760	34	29,279,575	15	5,836,174	32	48,105,900	10	4,968,000
Railways — Maritime Transport	8	3,197,500	24	36,139,325	6	1,506,000	21	36,759,435	8	29,189,125	16	24,314,430
Textile Industry............	2	988,400	..	....	4	8,061,600	..	....	8	10,969,200	..	....
Glass-making................	2	4,797,000	..	....	2	8,951,000	..	....	4	17,200,000	1	231,250
Miscellaneous...............	18	9,799,790	11	5,989,385	29	44,534,425	5	3,929,300	18	57,876,450	6	2,843,400
	183	166,997,020	78	90,830,600	232	345,178,610	80	117,916,274	265	650,216,270	68	157,862,060

[17] *Banque d'Outremer — Banque de Bruxelles — Société Générale de Belgique — Crédit Générale Liégeois.*

The increase of deposits in the savings banks of the Boerenbond and on the books of the Société Nationale de Crédit à l'Industrie does not mean that these two institutions have attracted deposits that normally would have been placed in the other banks. Naturally, we deduct the deposits in the National Bank of Belgium representing balances left by banks that are clearing-house members, and which figure in the reserve on their balance sheet.

The increase in deposits has not been proportional to that in circulation. However, the enormous inflation of 1919, following the gradually increased circulation during the war, resulted, after the exchange of the marks, in an accumulation of liquid funds left on current account, not yielding interest, in the National Bank of Belgium.

SLOWING UP OF DEPOSIT ACCUMULATION INDEX OF LACK OF CAPITAL. This is not the place to enter into a discussion of theory, the interest of which, however, has not escaped us. It has been seen that, beyond certain limits, determinable empirically, the bank note cannot be assimilated to capital; that the deposit, on the contrary, can be assimilated to capital, is not influenced by a factitious creation of buying power, and that, in reality, the slowing up of the accumulation of deposits gives us the measure of the country's impoverishment in capital.

It is fitting to cite among the other causes that have contributed to hindering the accumulation of deposits, the loans to the government and private organizations which have absorbed a part of the bank notes, and, finally, the issue of Treasury Bonds, the short time investment par excellence that has drawn away a considerable part of the Belgian savings. The interest rate of these investments was very attractive, and the State enjoyed a greater prestige than the banks. This, moreover, appears to be the principal cause of the failure of the deposits to increase proportionately.

ORDINARY AND SHORT TERM TREASURY BONDS IN CIRCULATION

31 décembre 1919	Frs. 1,104,000,000
31 décembre 1920	Frs. 2,148,000,000
31 décembre 1921	Frs. 4,445,000,000
31 décembre 1922	Frs. 3,876,000,000
31 décembre 1923	Frs. 4,132,000,000
31 décembre 1924	Frs. 4,805,000,000
31 décembre 1925	Frs. 5,657,000,000

It should be noted that a part of these bonds were subscribed abroad as well as by the banks.

To meet the competition of the State, and to continue to hold and increase their customers and depositors, the banks had to extend their chain of agencies, raise the interest rate on deposits, and issue short time certificates imitating to a certain extent the features of the Treasury Bonds.

It should be said that the bank deposits, although they did not develop in proportion to the increase in the fiduciary circulation, could not be completely utilized by the credit establishments. Two facts prove this:

(1) The banks bought, more or less at the solicitation of the government it is true, large quantities of Treasury Bonds as investments for their available assets, and this was even one of the reasons why the banks were hostile in the beginning to the forced consolidation of the floating debt, and why, when it was finally necessary to resort to this measure, they were granted special privileges.

(2) The Brussels banks placed important sums on deposit with the Société Nationale de Crédit à l'Industrie in return for the cession of part of the latter's commercial portfolio, as the reports of that association indicate.

One cannot help feeling that the expansion of the network of bank agencies has been perhaps a little too rapid, and is partly influenced by questions of prestige, and one has the right to ask whether the bitter competition between some of them to take depositors from each other is justified, and whether, following the example of the study being made in Germany, it would not be wise for the large Belgian credit establishments to divide the country in order to avoid a swarming of agencies in localities where their multiple presence is not justified from an economic point of view.

Foreign Banks in Belgium. A country affording transit facilities, situated at the crossroads of powerful industrial and commercial civilizations, endowed with one of the world's best ports, and providing for a vast hinterland, Belgium necessarily presents an interesting field of action for foreign banks. Therefore, the establishment of foreign banks or their subsidiaries in our principal centers dates quite far back, and foreign banks have

succeeded in playing an important part on the discount market.[18] Before the war there were eleven of them, not including the Banque internationale de Bruxelles, which had German affiliations. They are enumerated here:

Crédit Lyonnais (established in Brussels in 1888)
Comptoir Nationale d'Escompte de Paris (1870)
Société Française de Banque et de Dépôts (subsidiary of the Société Générale de France, established in Brussels in 1898, then in Antwerp and Ostend)
Société de Crédit Industriel et Commercial
Crédit du Nord
Banque de Paris et des Pays-Bas (established in 1872 in Brussels, then in Antwerp)
London and River Plate Bank (branch situated in Antwerp)
Société Suisse de Banque et de Dépôts
Banque Internationale de Commerce de St. Petersbourg
Disconto Gesellschaft
Deutsche Bank (successor of Basler and Company)

This list obviously does not include private bankers of foreign origin, such as Messrs. von Bary, nor the bankers known as "international," who, even if they have acquired Belgian nationality, preserve close relations with other foreign houses.

French Banks in Belgium. The French banks were the most numerous. "French banks were attracted to Belgium for several reasons. The great financial credit establishments had at their disposal large deposits which it was not always easy to invest in commercial paper. They found an outlet here, and competed actively with the Belgian banks on the discount market. On the other hand, fear of fiscal pressure in France caused important quantities of securities belonging to the French to flow into Belgium." We would add to this that monetary community, legal since 1865 and effective since the Revolutionary years and the conquest of Belgium by the Convention, helped facilitate French banking expansion in Belgium. We may cite still

[18] A. E. Janssen: *Les Conventions Monétaire,* Bruxelles 1911, p. 406: "The National Bank of Belgium does not control, as formerly, the discount market, where competition has become very keen, on account of the abundant resources of the Belgian and foreign banks established in Brussels and Antwerp."

other reasons: the payment of the war indemnity in 1870 by France to Germany caused movements of funds in Belgium; it was through the agency of Belgian banks and French establishments in Brussels that the French banks placed their assets on contango in Germany; the political action of France in Belgium likewise could not fail to favor the expansion of the French banks. Reasons, therefore, are not wanting to justify the expansion of French banks in our country.[19]

German Banks. The apparent inactivity of German banks might appear disconcerting at first sight: Antwerp was the shipping center for the merchandise of the Ruhr and part of Rhenish Prussia, as well as the Reichland of Alsace-Lorraine; our national port was also the linehead for numerous German nagivation companies, and, lastly, big business in Antwerp included many Germans among its most prominent members.

The reasons for this apparent abstinence, however, seem quite easy to discern. German capitalists played an important part in Belgian economics. Fewer in number than the French element, they nevertheless had more influence; the members of the French colony belonged frequently to the small merchant class, who resorted to the ordinary credit of the banks. On the other hand, the Germans in Belgium devoted themselves to large commerce, exportation and industry; though less numerous, they constituted a sort of aristocracy that preserved strong ties, both social and financial, with Germany.

In addition, the German financiers found it more expedient to invest in the foreign banks by taking shares in them. It was thus that the Banque Internationale de Belgique was formed in

[19] Although Clarke was able to say that true international balance would always remain a mystery to us, it is only too certain that France's balance is unchangeably creditor. One of the reasons it is so cruelly so for Belgium is that we make considerable foreign payments through Paris. Thus we have to buy paper on Paris to make payments abroad. If we subscribe to the Argentine loan, it is through the intermediary of Paris that we send overseas a large part of the 300 millions we have subscribed. . . . Add to this the enormous sums that French fortunes, anxious to escape the proposed income tax, have intrusted to Belgian banks. The coupons of half a billion thus placed are detached in Belgium and redeemed in the French exchange. Thence a rise in Brussels of paper on Paris. When this capital is withdrawn, the exchange rises under pressure of the withdrawals, as in September, 1911, during the anxiety of the Franco-German conferences in regard to Morocco." (Van Elewyck)

1898 by Bleichroeder and the Disconto Gesellschaft, and that the Darmstädter Bank represented German capital in the Crédit Anversois. In 1907 (November 16), Professor Ansiaux wrote in *L'Action Wallonne* that German capital had large holdings in a Liége bank.

The formation of industrial enterprises to operate in Belgium interested the Germans keenly; especially in the matter of electricity, they sought advantageous alliances with our industry. The Allgemeine Electrizitäts Gesellschaft and Siemens und Halske had a predominant situation in the country's industry; it was thus that the Société Financière de Transports et d'Entreprises Industrielles was founded by the Disconto, the Dresdner Bank and the Gesellschaft für Electrische Unternehmungen. The Compagnie Hydro-électrique Anversoise was founded under the auspices of the Schückert-Schaafhausenscher Bankverein group.

They sought also to bring into the country the funds industrial Germany lacked, either by collecting deposits or by investing funds in Belgian savings accounts.

The war entirely upset this situation and destroyed, at least for a time, German influence. One of their banks, the Brussels subsidiary of the Deutsche Bank, was sequestered. The liquidation of this establishment not being completed, it is impossible to tell what is the amount of the sequestered capital in its charge.

English and American Banks. The end of the war saw established in Belgium a swarm of foreign banks, principally English and American, that devote themselves especially to discounting Belgian bankers' acceptances outside of the banks, as well as to operations regulating the exchange, which did not always have the effect of bringing the rates to the same level.[20] They dispose of capital for the accounts of their compatriots (purchasing industrial stock and undervalued State securities for American account especially and, during the last few months, for German account). Foreign bankers grant, to our bankers as

[20] Even before the war, Van Elewyck wrote the following: "But do not the French and German banks established in Belgium . . . find in the fluctuation of the exchange profits that would escape them if the exchanges were stabilized? Necessarily they would be stabilized at a higher rate, which would noticeably slow up the activity of the agencies devoted to placing in our country the German, French, Russian and other securities that it is advantageous for them to sell."

well as our manufacturers and merchants, documentary acceptance credits, advances on documentary drafts (Far East and Latin America), advances on merchandise and even blank credits and banking facilities; they receive for discount or rediscount our commercial paper, whether bankable or not, as well as local paper; they intrust deposits in francs to our banks and facilitate the accomplishment of operations with a maturity sufficient to cover the risk of the exchange. Sometimes, too, but rarely, they lend their support to big industry, metallurgic or electric construction companies, and assist them in undertaking business abroad by furnishing them with working funds, either in the form of renewable acceptance credits or by advances on current accounts. Finally, the foreign banks have absorbed hundreds of millions in Treasury Bonds.[21]

These are the credit establishments installed in Belgium at the present time:

American Express Company
American Foreign Banking Corporation
Continental City Bank and City Exchange
Dominion Express Company of Canada
Guaranty Trust Company of New York
International Bank for Import and Export
Lazard Brothers and Company, Ltd.
Lloyds and National Provincial Foreign Bank, Ltd.
National City Bank of New York
Northern Commercial and Industrial Bank of Archangel
Société Hollandaise de Banque

[21] Since the stabilization of the franc, the American banks have altered their policy and, instead of seeking temporary profits on exchange transactions, strive to develop permanent business with Belgian customers: they endeavor to control the credit operations relating to wool and cotton imports by offering acceptance credits in dollars. They meet with the sharp competition of the French and British banks, in the wool business, for instance. Belgian wool manufacturers are accustomed to receive offers of credit from representatives of London banks which have no branches in Belgium. Public opinion has been moved quite recently by numerous endeavors of British financial and industrial groups to secure control of plants in the Flemish part of the country. British banks have already interests in Belgian tobacco and chocolate manufactures as well as in breweries. German credits have also been recently offered. Lastly, Dutch banks are participating in issues of capital of new companies and have floated loans of Belgian steel plants on the Amsterdam stock-exchange.

Westminster Foreign Bank, Ltd.
Bank of London and South America, Ltd.
Comptoir National d'Escompte de Paris
Société Française de Banque et de Dépôts
Banque de Paris et des Pays-Bas
Crédit Lyonnais

Let us add that, according to Dunn, Belgian and American capital has contributed to the formation of investment organizations that take holdings in the industrial enterprises established in Europe: the Solvay group (Mutuelle Mobilière); Lee, Higginson and Company; White, Weld and Company; Clark, Dodge, and Company and Messrs. Philippson and Company have founded the American-Belgian Financial Corporation. Similarly, Messrs. W. A. Harriman, Inc., of New York, have founded, with the Niederösterreichische-Eskompte-Gesellschaft, of Vienna, the Banque de Bruxelles, the Union Européenne Industrielle et Foncière de Paris, and the Comptoir d'Escompte de Genève, a holding company with a capital of $4,000,000: the "Central European Investment Company" which is to have the mission of buying European industrial securities, notably Belgian, and issuing corresponding bonds in the United States. The same group, practically: Harriman, the Banque de Bruxelles and the Banca Commerciale Italiana, presided over the amalgamation of the Bank Handlowy and the Bank Zjedioczolyck Zien Pobskich. It is estimated, moreover, that the total American industrial investments in Belgium amount to between fifty and sixty million dollars at the present time.

The sale of American automobiles on the instalment plan has attained a certain importance in Belgium. The General Motors Acceptance Corporation deals in credit sales of the General Motors cars; the Belgian distributors for the Ford Motor Company usually have the drafts accepted by their customers discounted by Belgian banks.

The situation has therefore been profoundly modified, and the expansion of Anglo-Saxon banks is an indication of a new condition, resulting largely from the fact that the United States and Great Britain, in comparison with continental Europe, had preserved gold reserves and sound currency.

Belgian Banks Abroad. The expansion of Belgian capital

abroad has been manifested especially in industrial investments, by the creation of organizations capable of utilizing the products of Belgian factories. That is why there were established before the war a considerable number of street railway and lighting companies that, founded by Belgian capital and utilizing Belgian engineers and material, operated abroad. Their profits were paid, in the form of dividends, to Belgian stockholders. Important Belgian funds were also invested in oil wells in Russia and Rumania, in rubber and oil palm plantations in Dutch East Indies (Banque des Colonies). For the year 1913, the researches of Professor F. Baudhuin have ascertained that 138.7 millions in dividends came in from abroad, principally from street railways constructed by us in all latitudes. As early as 1911, Mr. A. E. Janssen pointed out this situation: "It is undeniable, since Belgian industry has sought outlets abroad, since Belgian capitalists have built railways and tramways practically everywhere, and since they have established real estate loan companies, metallurgic and other organizations, that the exportation of capital has increased considerably, sometimes influencing the exchange rates unfavorably."

For the activity of the banks themselves, this situation had obvious consequences: we exported a large amount of material without their intervention being manifested beyond the frontiers. The financing of these operations took place in the interior of the country, and it had the effect rather of stimulating the establishment and extension of financial trusts. As for the direct exportation of our products, it was often accomplished by foreign houses, principally German, and even since the war, the Belgian consul at Hamburg has ascertained that more than 150 Belgian firms are still represented there by German exporters. These "export vertreter" were particularly numerous and powerful in Antwerp, through which port the exportations were, and still are, made. This practice of course left little room for the activity of the Belgian banks, which specialized in transactions carried on with South America, the Near East and the Far East.

This figure, moreover, was notably insufficient for such an active country as Belgium, and the reasons that we have set forth above do not excuse the abstinence of the banks and their reluctance to create nuclei of activity and national expansion abroad. They remedied this somewhat, it is true, by investing in

BRANCHES OF BELGIAN BANKS ABROAD AND IN THE COLONIES

Year 1913	Banque Italo-Belge	Banque Belge pour l'Etranger	Banque du Congo Belge	Total
France..........	.	.	.	.
England.........	.	1	.	1
Germany........	.	.	.	.
Roumania.......	.	.	.	.
United States....	.	.	.	.
Argentine........	.	.	.	.
Brazil...........	3	.	.	3
Chile............	.	.	.	.
Uruguay........	1	.	.	1
Turkey..........	.	.	.	.
China...........	.	3	.	3
Egypt...........	.	1	.	1
Belgian Congo...	.	.	5	5
Total.........	4	5	5	14

foreign banks: 14 in 1913 (*cf. supra*), but this indirect control was far from having the efficacy of action through branches directed by Belgians.

Since the war, while these investments increased, the number of Belgian banks abroad also increased.

BRANCHES OF BELGIAN BANKS ABROAD AND IN THE COLONIES

Year 1925	Banque Italo-Belge	Banque Belge pour l'Etranger	Banque du Congo Belge	Crédit général du Congo	Total
France.......	1	1	.	.	2
England.....	1	1	1	.	3
Germany.....	.	1	.	.	1
Roumania....	.	2	.	.	2
United States.	.	1	.	.	1
Argentine....	1	.	.	.	1
Brazil........	5	.	.	.	5
Chile	1	.	.	.	1
Uruguay.....	1	.	.	.	1
Turkey......	.	1	.	.	1
China........	.	4	.	.	4
Egypt.......	.	5	.	.	5
Belgian Congo	.	.	29	8	37
Total......	10	16	30	8	64

The South American countries particularly have attracted the attention of the banks.

It is just to add that our banks have rapidly succeeded in winning an honorable position in the markets where they have been introduced. In China, through the agency of the Banque Belge pour l'Etranger, Belgium took part in the International Consortium of Chinese affairs, which monopolized the launching of all industrial enterprises. And the Bank even caused the Consortium to allow orders for material to be given to Belgium as the Belgian share in the Consortium.

An interesting fact to note is that the Banque Belge pour l'Etranger possesses, for its Chinese branches, the right of issue, of which it scarcely makes use, however, as appears from its balance sheets.

The Société Générale de Belgique has recently founded in Spain the "Banco Internacional de Industria y de Commercio" in a manner that eludes to a certain extent the draconian prescriptions of Spanish legislation in regard to foreign banks and their branches in the Iberian peninsula.

Belgian Foreign Real Estate Loan Companies. Before leaving the question of Belgian banks abroad, it is fitting to point out that Belgian capitalists have founded in Antwerp and Brussels real estate loan societies having their field of activity chiefly in South America. They are generally under the patronage of the Belgian industrial banks. They number about twenty.

We may mention for Antwerp:

	Capital
Industrielle et Pastorale Belge sud-américaine	15,000,000
Banque Belge de prêts fonciers	39,000,000
Crédit foncier Sud-américain	22,500,000
Crédit Général du Canada	10,000,000
Société Générale belge-argentine	14,000,000

In Brussels, in addition to companies with a capital of less than five million, there are:

Compagnie agricole et hypothécaire Argentine	15,000,000
Banque Belgo-argentine	12,000,000
Cie Immobilière hypothécaire Argentine	10,000,000
Crédit Foncier d'Extrême-Orient	10,000,000

Belgium being a country with a very slight emigration, the only reason that can be assigned for the mortgage operations of Belgians abroad is the high income from loans in new countries.

If Belgium was, in exact figures, the sixth industrial country of the world, her banking expansion abroad did not, and does not yet, give the least idea of the real economic power of this little over-industrialized territory.

The Bank of Issue of the Belgian Congo. There is, for the exclusive use of the Colony of the Belgian Congo, a bank of circulation having its main office in Brussels.

Founded in 1909, with a capital of 2,000,000 francs, the Banque du Congo Belge was provided with the right of issue and a charter similar to that of the National Bank of Belgium, by an agreement concluded with the State, July 7, 1911. At the same time, its capital reached five million francs; it amounted to twelve millions (50% paid in) in 1920 and twenty millions, completely paid in, in 1925. When it was granted its issue monopoly, the Banque du Congo Belge had to relinquish certain operations, such as promoting companies. A new bank was created to take them over: the Banque Commerciale du Congo. Between the two banks an agreement has established a very close operation: their branches are in the same offices, as well as their headquarters; their staff in the Congo is often common to both. In many respects, the Banque Commerciale du Congo acts as a "*comptoir d'escompte*" of the Banque du Congo Belge.

Although its by-laws were visibly inspired by those of the National Bank, the Banque du Congo Belge has more freedom in its transactions on account of the peculiar conditions of colonial commerce and the greatness of the distances.

The profits are divided as follows:

(1) 5% to the legal reserve until the latter has reached ten per cent of the company's capital;

(2) 6% to the capital designated and paid in.

Of the surplus:

(3) 50% to the Colonial Treasury;

(4) 15% to the directing boards;

(5) the balance to the stockholders or to certain appropriations.

The Banque du Congo Belge, a strictly private institution in its origin, had as founders most of the large Belgian banks, which have always preserved a dominant position in its boards.

The Bank has the monopoly of issue for the Colony. The issues are not made from the African offices, but are decided in Brussels. The notes are not legal tender in Belgium, but they can be redeemed in Brussels by the purchase of demand drafts on Matadi.

The total demand liabilities of the Bank cannot surpass triple the sum total of the capital and reserves; as for the note circulation, it cannot surpass triple the metal reserve. By "metal reserve" (Article 10 of the agreement) is understood to mean:

(1) gold and silver coins and subsidiary coins that are legal tender in the Belgian Congo;

(2) gold coins of all countries;

(3) notes of the National Bank of Belgium, the Bank of France, the Bank of England, the Bank of the German Empire. However, the Colonial Minister has the power of temporarily excluding from the reserve the notes of one or another of the establishments mentioned above;

(4) gold or silver in ingots, nuggets or dust, according to the degree of fineness and the current market price;

(5) foreign drafts eligible for rediscount and payable in gold, in the proportion authorized by the Colonial Ministry.

During the war, to compensate for the separation between the African offices and the main offices in Brussels caused by military operations, an administration was established in London as early as 1914. This supplied without interruption financial service for the Colonial companies. Though, at the start of hostilities, the rates for Colonial products depreciated, the needs of the Allied armies soon gave a new impulse to the mines and agriculture of the Belgian Congo. The transportation crisis alone hindered the colonial expansion of Belgium. On June 30, 1914, the note circulation of the Banque du Congo Belge amounted to 5,187,380 francs; on June 30, 1919, it reached 12,158,707 francs. The movement of accounts rose from 171,291,950 francs in 1913–1914 to 1,442,175,986 francs in 1918–1919.

If we dwell somewhat on the activity of the Banque du Congo Belge, it is because the development of the Congo finances is not

very well known, and because the prosperity of the Colony during the war has led to interesting developments: the Banque du Congo Belge founded about twenty agencies there; foreign financial establishments also came to create agencies in the Congo: the Standard Bank of South Africa at Elisabethville and the Banco Nacional Ultramarino at Kinshasa. It is well known that British and Portuguese elements are numerous and active in the centers mentioned above.

After the example of many colonial banks of circulation, the Banque du Congo Belge has opened a branch in a foreign possession, at Dar-es-Salam (a British possession).

To pass over in silence the rôle of the Banque du Congo Belge in regard to exchange during the war would be to neglect an interesting aspect of the question. Borrowing in London, in pounds sterling, the Colonial Treasury likewise sold there the gold from the working of the Kilo-Moto mines. Thus, through the agency of the London Administration of the Bank, it caused a large movement in pounds. The transfers from London to the Congo and vice versa amounted to about 15,500,000 pounds and the Bank succeeded in stabilizing the rate of the Congo franc at an average rate of 25.45 francs.

After the war, the Congo franc, which had moreover only a *de facto* existence, found its fortune bound anew to that of the Belgian franc, and the rise of world prices, as well as the rise of prices on the Belgian market, reacted on the note issue of the Banque du Congo Belge.

(In thousands of francs)

Date	Capital	Reserve	Circulation	Debit	Credit	Discount
30-6-1914	5,000	7,938	5,187	2,124	9,388	1,929
30-6-1919	5,000	17,196	12,159	34,360	52,288	13,313
30-6-1920	12,000	55,145	30,653	60,059	125,054	47,940
30-6-1921	12,000	33,241	34,260	57,416	116,403	71,655
30-6-1923	12,000	22,469	34,016	41,008	114,670	81,907
30-6-1924	12,000	23,174	44,997	74,889	148,921	117,335
30-6-1925	20,000	27,209	60,436	94,369	190,752	160,459

The considerable increase in the commercial portfolio is noticeable at once. Unfortunately, it also includes Treasury Bonds,

which prevents us from ascertaining the importance of the increase due to purely commercial operations. The "debit" item also shows constant progression. If the different items of the balance sheet of the Banque du Congo Belge bear indisputable traces of the inflation suffered by the metropolis, it is none the less evident that the development proper of the Colony has contributed to the expansion of the Bank's activity. The fact that most of the Belgian colonial companies have their seat of exploitation in Africa and their administrative seat in Brussels or Antwerp evidently does not favor the development of banking activity in the Congo itself.

One of the weakest points of the banking organization of the Congo is real estate loans. The land there has no fixed market value, and the colonists do not find it easy to procure advances on mortgages. Personal credit has to compensate for real estate loans and private credit establishments make them only with extreme prudence.

Formerly the Banque de Bruxelles had agencies in the Congo; they have been ceded to its offshoot in the Congo, the Crédit Général du Congo.

The Société Nationale de Crédit à l'Industrie. In a review of Belgian banking movements after the war, it is fitting to give some place to a foundation to which the public powers and the Central Bank both contributed.

In all countries during the war, there has been noted a need for diverting to credit with medium maturity a part of the activity of the banks, as well as to exportation credit, following the initiative of the Germans. It was largely with this purpose that the *British Trade Corporation,* with a capital of ten million pounds, was formed in England by royal decree, that the United States Congress passed the Edge Act and that the War Finance Corporation was kept in existence.

The attention of Belgian financial and political circles was likewise drawn to this point, especially since before the war the exportation of Belgian products was in the hands of foreign brokers, frequently Germans located in Hamburg. In addition, the question was complicated for our country by the almost general lack of credit with medium maturity, the need for which was so great that, against its will, the National Bank of Belgium was

obliged to accept paper subject to renewal to meet the requirements of industry to a certain extent. "When, before the war, industry of moderate importance succeeded in obtaining industrial credit, it was always with precarious title, and also to a very insufficient extent, in the form of discount credit of drafts renewable for three months at a time, without guarantee that such renewals would be continued, the money thus obtained from the banks coming from their demand deposits."

Medium term credit appealing little to the private banks, it was the National Bank that solved the problem of furnishing the necessary capital for the proposed organization: it devoted to this, to the amount of twenty-five million francs, its profits undivided during the war, and shares in the new *Société Nationale de Crédit à l'Industrie* (National Association for Industrial Credit) were distributed to the Bank's stockholders, with the approval of the government.

According to the terms of Article 3, § 1 of the charter, the new institution had as its purpose, "facilitating for organizations the mobilization of their short and medium term credits." "Advances shall be negotiated through the agency and with the guarantee of a bank, credit establishment or any other similar institution" (Article 3, § 3), for instance, a discount bureau of the National Bank of Belgium. This provision reënforced the surety offered to customers of the Société Nationale, and, at the same time, interested the other banks in its existence, by not placing it in competition with them at the start.

Independently of the capital proper, the resources of the Société Nationale de Crédit à l'Industrie are the following:

(1) the issue of bonds for an amount equal to ten times the amount of the capital, the interest on the bonds with more than five years maturity being guaranteed by the State;
(2) the issue of bank certificates for one to five years;
(3) the acceptance of *time* deposits, yielding interest.

In return for the guarantee it gives the bondholders, the State appoints a government commissioner and levies a tax equal to a quarter of the second dividend granted on the stocks.

Until October 1926, the relations between the Société Nationale de Crédit à l'Industrie and the National Bank of Belgium were

extremely close: use of the offices and staff of the Bank by the Société, "interlocking directorate," etc.

The table below gives the movement of the principal items of the balance sheet of the Société Nationale de Crédit à l'Industrie, showing its great activity, as well as demonstrating its utility. It will be seen that the time deposits of the Société Nationale de Crédit à l'Industrie were very popular, and at the end of 1925 they amounted to almost a tenth of the total deposits in all the Belgian banks. A peculiar feature revealed by the reports of this institution should be emphasized here; the private banks from the beginning have intrusted to the Société Nationale de Crédit à l'Industrie on time deposit a part of their available assets for which they found no use in short time operations, owing to the shrinkage of their commercial portfolios, and which they could not utilize for long time investments. It is partly due to this practice of the private banks that the Société Nationale de Crédit à l'Industrie has such abundant funds at its disposition.

In spite of the disinclination of the public for securities with a fixed income, the Société Nationale de Crédit à l'Industrie has succeeded in placing more than 800 millions in bonds, which has caused it to double its capital-stock to keep it in the legal proportion to its bond issues. "In tracing the outline of the Société's operations, the promoters did not particularly foresee its eventual intervention in financing the indemnities to be awarded to war victims." But government needs having absorbed the resources obtained from the loan and taxes, the Cabinet asked the Société in 1919 to consent to mobilize the five year registered securities issued to represent advances granted on the German requisition notes. Then the Société was persuaded to mobilize the other indemnity securities for war damages. Here is the share of the Société Nationale de Crédit à l'Industrie in financing the restoration of the country:

Financial year 1919–1920	Frs. 432,301,200
Financial year 1920–1921	Frs. 813,461,100
Financial year 1921–1922	Frs. 445,504,900
Financial year 1922–1923	Frs. 280,555,000
Financial year 1923–1924	Frs. 101,172,800
Financial year 1924–1925	Frs. 100,361,880
Financial year 1925–1926	Frs. 57,216,120
Total	Frs. 2,230,573,000

Fiscal years	Portfolio of paper	Treasury bonds	A.N.I.C.[22] bonds	Security	Capital	Bond Loans	Time Deposits	Credits
1919–1920	253,748,604	150,000,000	....	....	25,000,000	93,178,000	215,225,754	86,093,429
1920–1921	538,769,090	250,000,000	....	....	25,000,000	250,726,000	413,944,305	127,833,273
1921–1922	891,521,223	135,000,000	....	....	50,000,000	523,806,000	358,061,941	132,072,857
1922–1923	1,238,938,460	....	....	....	50,000,000	756,831,000	361,490,638	138,061,356
1923–1924	1,468,175,138	....	....	....	50,000,000	803,660,000	476,725,517	141,732,046
1924–1925	1,114,621,405	....	843,300,000	39,707,167	50,000,000	819,680,000	988,576,664	102,428,624
1925–1926	387,878,311	....	861,133,000	65,904,694	50,000,000	765,234,000	298,468,114	86,868,191

[22] Association Nationale des Industriels et Commerçants.

These operations would inevitably divert a large part of the Société's resources from operations for exportation credit, the great utility of which for the country it realized. But conferences between the Société Nationale de Crédit à l'Industrie, the government, and the war sufferers resulted in 1924 in the creation of the Association Nationale des Industriels et Commerçants (A.N.I.C.) (National Association of Manufacturers and Merchants), which was to finance the reparations for the war damages by the issue of bonds. In the balance sheets of the Société Nationale de Crédit à l'Industrie, these bonds replaced promissory notes signed by the war sufferers to represent advances made to them. However, the placing of these bonds has been hampered by the dullness of the financial market.

In spite of this situation that it deplored, the Société Nationale de Crédit à l'Industrie undertook the financing of several important industrial shipments to foreign countries, particularly of railway material to Greece and South America.

It is seen that, for the last two financial years, an item " security " appears, which is almost doubled from one year to the next. In fact, it includes the various indorsement and surety pledges furnished by the Société Nationale de Crédit à l'Industrie, almost exclusively abroad, in favor of Belgian undertakings. At a moment when the Belgian capital market was very tight, the Société found it opportune to put its signature at the disposal of exporters, who could thus obtain advances abroad.

The position of the Société Nationale de Crédit has recently been modified so as to enable it better to develop its new policy of credit for exportation: it had grown up under the patronage of the National Bank of Belgium. It has been decided that from now on the Société had enough prestige and strength to separate from the parent bank; henceforth it will have its own offices and staff. Its capital has been tripled, and a block of fifty millions of stock subscribed by the private banks represented on its board. As for the bonds of the Association Nationale des Industriels et Commerçants, they have been taken over to the account of the State which will refund the sum to the Société at the rate of twenty-five millions a month.

The original activity of the Société is thus restored, and the financial press has already pointed out at various times the im-

portant part it hopes to see it play in financing foreign commerce. But it continues to deal, in principle, only through the agency of a guaranteeing bank or the discount bureaus of the National Bank of Belgium.

The Credit Banks of the Boerenbond. Among the coöperatives for agricultural credit, the credit banks of the Boerenbond (association of peasants) must be placed in a class by themselves.

The Boerenbond, having its central office at Louvain, is a very centralized Roman Catholic enterprise which organizes in the villages and rural communes of the Flemish part of Belgium numerous social and economic undertakings: guilds of peasants, grouped in federations by arrondissements; guilds of farmers; federations of gardeners; bureaus for buying and selling agricultural products, artificial manures and seeds; dairy inspection services; mutuals for insurance against fire, hail, the mortality of cattle, horses, etc.

In 1925, the Boerenbond had more than 100,000 members divided into 1,150 guilds. The Boerenbond controls dairies, a company for land-clearing and drainage, and a rural electric service. It is said to have interest in a Ferry-boat company between Ostend and London, which carries to England important shipments of Belgian eggs, butter and truck products. In collaboration with the University of Louvain, it has undertaken a campaign for improving seed, cattle and live stock. Finally, and this interests us particularly, it has established credit and savings banks in the form of coöperative societies. Their central office is the "Caisse Centrale de Crédit du Boerenbond," situated in Louvain. The table below gives the importance of the credit and savings groups of the Boerenbond.

Years	Number of rural banks in Belgium	Number of banks affiliated with the Boerenbond
1897	159	95
1910	643	304
1920	1,127	733
1924	1,308	912
1925	1,338	940

The Caisse Centrale de Crédit opens credits, receives savings deposits, makes mortgage loans, favors the construction of low-priced dwellings and invests in bank or negotiable securities the surplus of its available funds. Incidentally, it has been induced to grant advances for the reparation of war damages, and it has contributed in this way to restoring to cultivation nearly six thousand hectares situated in the Yser zone.

The table below will give an idea of the importance of the Boerenbond's deposits, which are the consequences of skillful propaganda, the increase of the peasant's wealth and the intrinsic merits of the work.

DEPOSITS IN FRANCS

Year	Demand	Time	Total
1897	65,923	....	65,923
1900	378,892	....	378,892
1910	11,983,201	....	11,983,201
1917	76,027,550	1,334,750	77,362,300
1918	171,550,918	40,913,963	212,464,881
1921	190,545,212	135,825,548	326,370,760
1923	244,093,638	239,422,231	503,515,870
1924	312,580,442	282,041,518	594,621,960
1925 [23]	317,540,426	337,473,094	655,013,521

The Caisse Centrale of the Boerenbond possesses a very important portfolio of State and industrial securities; in 1925, it amounted to 400 million francs, out of assets of 800 millions. It has been learned from press articles that this included a considerable amount in Treasury Bonds.

The material power of the Boerenbond and its Caisse Centrale de Crédit certainly deserves mention, and constitutes an important demonstration of the Belgian peasant's disposition for saving and association. The work of the Boerenbond also proves that Belgian agriculture is supplied with a credit organization that is both flexible and strong. But there are other particularly interesting facts to point out: one of the fundamental causes of the

[23] Total amount of deposits in millions francs:

1926	752
1927	966

Boerenbond's success lies in the close alliance of the Catholic faith and the social and economic interests of the members. The faith of the Flemish peasant is robust and alive; but in the Walloon section of the country the religious character of the work is far from exercising the same influence. In Flanders, the village priests take an important part in the propaganda of the Boerenbond, which exerts considerable influence in politics.

The Caisse Centrale de Crédit of the Boerenbond does not publish the composition of its security portfolio. (It amounted to 342 millions in 1926 and 468 million francs in 1927.) Nevertheless, from certain concordant indications, it is possible to assert that its directors have close alliances with the Flemish banks, those known as the "Louvain" group; the Volksbank van Leuven, the Algemeene Bank Vereeniging, etc. The result is that, without investing itself in certain commercial operations, the Caisse Centrale de Crédit places at the service of the affiliated banks its deposit power and the support of the hundred thousand families affiliated with the Boerenbond. In addition, the latter, through its financial branches, supports a certain number of industries and enterprises related to the preparation of agricultural products and their commerce: breweries, flour mills, vegetable canneries, chemical fertilizing manufactures, starch works, beet sugar factories, etc., and also the linen and cotton industry.

Thus there has been elaborated a vast centralized agricultural organization that furnishes its adherents with moral and social encouragement, credit, possibilities of improving their working methods, and markets for their products.

THE LABOR BANKS. A review of the situation of the Belgian banks would not be complete if the banking enterprises of the Belgian Labor Party were passed over in silence. An industrial country par excellence, Belgium contains 650,000 laborers that belong to socialist syndicates in a total of 1,300,000 industrial workers. The latter have at their disposal numerous and powerful consumers' coöperatives. The working population receives about 44% of the national income; the contributions of the syndicates paid into the Party's treasuries annually amount to 150 million francs.

"Outside of its political organization, the Belgian working class prides itself on economic organizations to which it attributes

a considerable, but not exaggerated, importance. These organizations justified the creation of a prosperous labor bank. The financial organizations of the Belgian Labor Party have assumed the economic forms of the capitalistic banking organizations.

"Although a corporation, the Banque Belge du Travail (Belgian Labor Bank) is a purely labor creation; the socialist coöperative "Vooruit" of Ghent has contributed almost unassisted to the formation of its capital; it subscribed more than 1,650 shares, out of a total of 2,000, the balance being subscribed by the directors of the coöperatives or socialist deputies, each for a minor amount."

It may be surprising to see a socialist undertaking adopt the form of a corporation instead of that of a coöperative organization, which is generally the one taken by proletarian enterprises. This exception to a rule both of theory and practice is explained by the realistic spirit animating the leaders of the Belgian Labor Party. A bank is an institution that, whatever be the political tendency of its founders, ought to be able to compete with its rivals on the money market, offer the same guarantees, and differ from them in no way by its business methods. It should also appeal to a general, undefined group of customers, who ask of it but two things: to render services and to be capable of restoring funds entrusted to it. Therefore it is indispensable to ensure a fixed capital for the bank, and under Belgian legislation, the corporation, in this respect, offers the third party the best guarantees.

It cannot be denied, however, that middle class banks prosper under the coöperative form, notably the Credit Unions, but they pursue a well defined end and are formed for the exclusive profit of their adherents; the labor banks, on the contrary, are not especially intended to serve individuals belonging to the Party.

Moreover, the majority of the capital belongs to the "Vooruit" which determines the Bank's policy. Hence, in 1925, the twenty directors practiced professions closely related to socialist activities.

Syndicate secretaries	3
Directors of coöperatives	8
Political delegates	6
Miscellaneous professions	3
Total	20

The Belgian "capitalistic" banks aim at insuring for themselves the control of different industries through shareholdings. The Banque Belge du Travail has followed the same policy. Founded in 1913, with a capital of a million francs, increased at present to ten millions, it built up an important security portfolio, including particularly the securities of companies belonging to the group of the socialist minister from Ghent, Anseele, who controls many important cotton spinning mills in Belgium.

From its foundation the establishment has displayed great activity. The Banque Belge du Travail has subscribed to numerous national loans and communal loans of the Crédit Communal, and has proceeded to issue stock in the companies of its group. With the "Vooruit," it has formed the "Armement Ostendais" corporation, by far the largest sea-fishing company in Belgium.

In 1922, the Banque Belge du Travail founded a cotton spinning mill and, in 1925, a Cellulose Industrial Company.

Three new branches were established at Mons, La Lavière and Charleroi.

The table below shows the progression of its accomplishments:

Years	Net profit	Dividend by share	
		of capital	of dividend
1921	Frs. 378,871.80	55.55	10.—
1922	Frs. 569,109.47	55.55	10.—
1923	Frs. 1,583,159.20	58.82	11.33
1924	Frs. 2,016,637.11	70.58	13.52
1925	Frs. 2,193,702.41	71.50	13.80

The portfolio of the Banque Belge du Travail includes, in addition to national government securities, loans of cities and provinces, stock in the eight textile organizations of its group and in numerous corporations: breweries, foundries, collieries, brick-kilns, refrigerating plants, etc.

Two particularly interesting foundations should be mentioned: the group of socialist spinning mills is at present studying the question of creating and developing vast cotton plantations in the Congo, and starting an artificial silk factory; the Armement Os-

tendais, a foundation of the Banque Belge du Travail, has in six years become the most important fishing-vessel outfitter in Belgium; at the same time, it also holds a portfolio of securities of industries related to fishing — maritime insurance companies, refrigerating plants, herring curing plants, etc. What is more, the Armement Ostendais has succeeded in establishing with all the "capitalist" fishing-vessel outfitters a company for the utilization of fish products, and another for the extension of the markets so as to combat the competition of the Dutch and German fisheries.

The Banque Belge du Travail has founded a subsidiary bank: a coöperative society, the "Comptoir de Dépôts et de Prêts," which is chiefly a deposit and discount bank. It proposes to "concentrate the financial operations of the Belgian labor organizations, and be a substitute for the savings banks existing within the coöperative societies, collaborating with them."

This new bank has just got the control of a labor bank in Antwerp, which will be turned into a branch. It will open agencies in Liége and Verviers. In this rich industrial region, the custom of several large iron plants is to manage savings banks for the use of the workers. Their deposits are very large: those of the Cockerill iron and steel works surpass fifteen million francs. The labor banks do not conceal their desire and purpose to attract into their banks these proletarian savings, and to use them for their own ends.

Certainly, the Belgian labor bank movement is still unimportant in comparison to the mass of so-called capitalist banks. But in our eyes, it has an extremely great importance: it is a factor for social peace, as in the United States, and a means of stabilizing the working classes by giving them a taste for productive saving.

The Financial Trusts. Belgium is the country where the first financial trusts were organized. They have rapidly won great favor with the public, attracted by their solidity, and have been fortunate in their undertakings. The financial companies concerned with street railways, gas and electricity, numbered forty before the war, with a total capital of 519 million francs. The value of the portfolios of the thirty companies about which we have been able to obtain information reached 611,284,000 francs. Since the war, others have been formed.

Among the most important of these companies, we mention:

the Banque Belge de Chemins de Fer (the Belgian Railway Bank), the Banque Industrielle de Belgique (formerly the Banque Empain), the Société Financière de Transport et d'Entreprises Industrielles (Sofina), the Banque des Colonies (the Hallet group of rubber plantations), the Société Internationale d'Energie Electrique, the Electro-Trust, the Société Générale Belge d'Entreprises Electriques, Société Générale de Chemins de Fer Economiques, Compagnie Belge de Chemins de Fer et d'Entreprises, Société d'Electricité et de Traction.

Most of these financial trusts have close relations with the large banks, such as the Banque de Bruxelles and the Société Générale, through interlocking directorates and reciprocal sharing in capital. In fact, some of them are really expansion agents for banks, and on their boards are very frequently found directors of the large credit establishments on shares and private bankers, who still have considerable influence in this sort of enterprises.

From the fact that these trusts launch street railway companies, lighting companies, etc., that often use Belgian materials, they likewise are constantly in touch with our great metallurgic and electric construction organizations, which in turn are often dependent on large banks. They share in forming the capital of new organizations or invest in those already existing. They find their resources in their own capital (or in frequent increases of the latter), in bond issues, and also in overdrafts on the banks of their group.

In their portfolios are found important quantities of the securities of foreign companies or of Belgian companies operating abroad. Certain financial trusts have close relations with London bankers or Canadian and American groups. The Belgian Financial Trusts have formed close connection with similar foreign trusts, especially in the electrical industry. For instance, the Sofina is allied with the Gesellschaft für Elektrische Unternehmungen, the Société Centrale pour l'Industrie Electrique, the Compania Hispano-Americana de Electricidad, the General Electric Co., the Swiss Bank für Elektrische Unternehmungen, etc.

THE REAL ESTATE LOAN COMPANIES. The existence of real estate loan companies goes back to 1835, the date of the founding of two real estate loan banks still alive: the Caisse Hypothécaire (which became the Crédit Foncier) and the Caisse des Proprié-

taires, which met with numerous difficulties on account of the inadequacy of the mortgage law.

In 1881, another company was founded at Antwerp. Then new ones arose, in response to a new need of the capital market.

It is especially during the last twenty-five years that the practice of mortgage operations has developed. Let us add that the Caisse Générale d'Epargne et de Retraite (Postal Savings Bank), through the intermediary of the agencies of the National Bank of Belgium grants mortgage loans to the lower middle classes.

The Belgian real estate loan banks can be divided into three classes:

There is the classic type, the financial establishment with its activity strictly limited, legally, to making mortgage loans on real estate located in Belgium, with the aid of bond issues running approximately the average length of time of the loans granted, which are generally payable in yearly instalments. The prototype in Belgium of this sort of establishment is the "Crédit Foncier de Belgique."

A second class of mortgage company has somewhat expanded this rigid program: the companies of this group have sought to procure other resources than those furnished exclusively by long term bond issues, and have created different kinds of deposit accounts or current accounts, either payable on demand or on more or less short time, but chiefly they have established on a vast scale the savings account system on the model of the Postal Savings Bank. These savings accounts include demand accounts and various accounts with previous notice of withdrawal varying from eight days to a year, and even more. The interest yielded varies according to the nature of the account, that is, according to whether it is payable on demand or at a more or less long time after notice is given; it generally varies from 4% to 4½%.

This system, especially since the war, enjoys public favor to such an extent that the companies employing it procure abundant resources and have reduced their bond issues perceptibly. Consequently, they hold demand or short time funds, while they replace this capital with long time mortgage loans; the incompatibility of the two operations is obvious.

Other mortgage companies, finding the field of action furnished by making mortgage loans too restricted, have modified their

charters at different times in order to deal in all sorts of transactions that come into the domain of the banks proper: credit, discount, issues, exchange, etc.

Although continuing to deal incidentally in mortgage loan operations, these credit establishments have really ceased to be real estate loan companies, but are banks dealing particularly in mortgage loans.

The principal banks of this kind are the " Caisse des Propriétaires " and, above all, the " Crédit Foncier de Belgique."

Another group of mortgage banks extends its operations to insurance of all sorts, principally life insurance, life annuities, etc. Also they generally deal in savings arrangements, tontines.

Therefore it is a question of mixed institutions that might as well be classified among the insurance companies as in the number of mortgage companies.

Lastly, there is a final category of companies: among these can be classed in a general way, with a few rare exceptions, all those formed since the war. They deal almost exclusively in mortgage loans for the account of others. In this sort of operation, the company acts only as intermediary between a capitalist investing his funds at simple interest directly in his own name on a mortgage, and a borrower who gives a first mortgage to the capitalist. The company intervenes in the contract to guarantee to the creditor the repayment of his loan and the payment of the interest. For this purpose, it becomes his co-debtor, jointly liable with the borrower. In addition, a unilateral agreement, that is to say, not including the lender, is made between the two debtors, according to the terms of which the borrower agrees to pay the company annual instalments fixed by the contract, for the repayment of the principal of the debt; this principal is thus built up by the company, and repaid by it to the capitalist on the stated maturity; a second mortgage is granted by the borrower to the company to assure the fulfillment of this pledge.

The war obviously paralyzed the activity of the real estate loan companies, and the difficulties accompanying the economic restoration of the country were felt especially by these institutions; the settlement of outstanding payments, the monetary depreciation following the placing of bonds, the fiscal burdens and

the hidden mortgages of the public Treasury had an unfavorable influence on the activity of the companies.

The monetary depreciation made serious difficulties for the mortgage banks. " While a two story house of a man of income, built under good conditions, was worth about 40,000 francs before the war, it is at present worth from 150,000 to 200,000 francs. Consequently the mortgage loans asked for are four times higher than before the war, and in order to satisfy their customers, the mortgage companies should have at their disposal four times as much capital." (Huberty)

In addition, the resources of the class of the population that built or bought their houses by means of mortgage arrangements have not increased in proportion to the cost of living, and in consequence, a part of the middle class must renounce a form of economy wholly deserving of interest and encouragement.

Since the monetary reform however, mortgage loans are again getting the favor of the investor, but the interest charged is still very high and out of proportion to the general trend of the money market.

Mortgages registered in Belgium
in millions of francs

1919	536
1920	914
1921	768
1922	1,234
1923	1,619
1924	1,638
1925	1,982
1926	1,802
1927	2,463

The above table does not, however, give the new yearly investments in mortgages: owing to monetary conditions, loans on real estate are, as a rule, only granted for five years. So that mortgages registered in 1919 may be renewed in 1924 and so on. Besides, public notaries are still important intermediaries in this business which therefore is not wholly in the hands of the real estate loan companies.

The Private Bankers. Along with the banks, financial companies and real estate loan companies, formed on shares, there

are in Brussels and Antwerp some thirty private bankers. There are also several in the provinces, but their activity is limited.

The businesses of the private bankers are formed as "private partnerships," or partnerships not issuing shares, in the majority of cases. The absence of publications on the subject of the private banks makes any study of them difficult.

A certain number of these banks are very important, not on account of the quantity of the business they do, but of its quality. Some of these private bankers, belonging to "international finance," play the rôle of "underwriters" in issuing corporation securities, subscribing outright a part of the capital which they then place with their customers directly, or through an agent. Certain ones confine themselves more and more to Stock Exchange transactions, others still deal in acceptance credit, but only for very important transactions negotiated abroad. Some of these bankers, the most powerful of whom are Messrs. Philippson and Company, Cassel and Company, Lamberta Co., Nagelmackers fils and Company founded in 1747, Josse Allard, Bunge and Company, sit on the boards of the financial companies and the great industrial banks. Most of them are of Jewish origin, and through the business and family connections that they have with foreign banking houses, they exercise an influence surpassing the importance of the capital, very great none the less, at their disposal. More and more are private bankers selected as directors of bank companies and industrial enterprises.

Bank Failures. Figures on this topic are certainly less complete than on any other. This is due to the fact that, usually, the "Recueil des actes de Sociétés" no longer publishes the balance sheets of banks that have failed, and the closing accounts of bankruptcies are rarely made public; it is therefore almost impossible to draw up reliable statistics. The National Bank of Belgium itself does not always have precise information on this subject, for long before their failure, most of the bankrupt organizations ceased to be given rediscount, as they did not possess the necessary guarantees, and the Institution of Issue therefore can obtain only indirect information. Also, private bankers not being subject to any legal obligation to publish their condition, it is extremely difficult to become informed of their affairs. The tables

compiled by the Ministry of Interior are published with considerable delay and therefore cannot be made use of.

We have drawn up, however, the following table according to the *Moniteur du Commerce Belge,* which publishes protests and declarations of bankruptcy, but without any statistical information.

Banks with shares	Number of Failures since November 11, 1918
Brussels	8
Antwerp	2
Provinces	6
Total	16
Private bankers	
Provinces	4
General total	20

If this table is compared to that of the general situation of the banks, it will be noticed that the proportion of failures to the total number of credit establishments is quite large; in addition, as a result of circumstances unfavorable to the expansion of the deposit system, four of these banks had a great many agencies and auxiliary bureaus in the Flemish provinces of the country: about five hundred. The material and moral harm done to small savings was therefore considerable, especially since these banks had succeeded in collecting about 170 millions in deposits against a total declared capital of about 50 millions. The figures of the actual losses are not known.

Most of the important failures occurred during the crisis of 1926, when the fluctuations of the franc led to numerous withdrawals of deposits. At this time the National Bank of Belgium gave sound credit establishments generous assistance to aid them in surmounting this difficult period and to avoid shaking public confidence further.

It is fitting to point out that the directing boards of approximately half of the banks that failed were guilty of serious irregularities that occasioned the intervention of justice. In all these cases, the courts rendered severe decisions, giving the criminals penal and civil sentences.

A remarkable fact: the great majority of the banks that failed had birth during the inflation, or had profited by it to expand considerably, out of proportion to their proper means of action, especially since, on the founding of the bank, part of the capital was paid up fictitiously. In a general way, in spite of the important losses affecting small depositors, the banks as a whole have not ceased to enjoy public confidence. Moreover, the establishments belonging to the two large Brussels groups have a deserved reputation for solidity, which, joined to the valuable privilege of rediscount at the National Bank of Belgium, acts favorably on public opinion.

THE CRÉDIT COMMUNAL. An institution created for ninety-nine years by a law in 1860 has the purpose of facilitating for the communes the loans they are obliged to contract when they are going to undertake a work of local utility for which the ordinary resources of communal finances would not suffice. This institution is a corporation called the "Crédit Communal."

The small communes, unknown and sometimes with unstable credit, would not be able to borrow on the money market, or only at excessive rates. The purpose of the Crédit Communal is to facilitate loans for these communes and provinces, or those guaranteed by them. The Crédit Communal therefore takes charge of issuing these loans and converting previous debts; it can issue uniform securities for the combination of several loans. In fact, the loans are represented not by securities indicating the name of the borrowing commune, such as the bankers issue in similar cases, but by bonds of the Crédit Communal. (P. Errera)

The stockholders are exclusively the provinces and communes; the shares, registered, are not fully paid up. When the Crédit Communal issues a public loan for the account of a commune, the latter promises to repay the loan in annual instalments. The Crédit Communal does not pay over the total proceeds of the issue; it retains five per cent, to which amount the commune becomes a stockholder and partially pays up its shares.

The Crédit Communal is directed by a board and supervised by a "Supervisory Committee." Their members are generally communal or provincial magistrates. A government commissioner may be appointed for the company.

"The profits to the amount of 5% are annually distributed to

the stockholders. The surplus forms a reserve fund that can be distributed only with the approval of the Minister of Finance. The members of the board of directors and the supervisory board together form the committee for admitting communes, provinces and public organizations desirous of contracting loans. However, the ballot for admission is dispensed with in the case of communes, provinces and organizations authorized to assign to the bank a certain income sufficient to cover their obligations."

As in the case of the operations of the National Bank, the government has veto power over operations contrary to law, the charter or the interests of the communes and the State.

The large communes do not employ the agency of the Crédit Communal, as their credit on the money market permits them to obtain very favorable terms from bankers or the public.

The following table gives the amount of loans floated by the Crédit Communal and by the communes direct:

LOANS FLOATED BY

In Millions of Francs	By Crédit Communal	By Communes and Provinces Direct
1919	726	328
1920	917	253
1921	758	121
1922	401	395
1923	270	22
1924	383	155
1925	533	23
1926	285	—
1927	298	462

THE POSTAL SAVINGS BANK. The postal service is charged with many financial operations designed to facilitate payments for the inhabitants of the country and encourage the habit of saving, a characteristic virtue of the Belgian people.

The General Postal Savings Bank was created by law in 1865, and the Caisse de Retraite (Retiring Fund Bank) was joined to it. Its main office is in Brussels, and every agency of the National Bank of Belgium and every post office acts as its branch.

The accounts of the Savings Bank are published in the *Moniteur Belge*, and audited by the Accounting Office.

"The principal function of the Bank is to receive the sums, no matter how small, intrusted to it by depositors. In order to encourage school children's savings, deposits can be made even of two centimes postage stamps by the pupils of the primary schools." (Errera)

The deposits received by the Savings Bank can be grouped in three classes:

(1) deposits on personal passbooks open to private individuals:

(2) deposits on Belgian rentes passbooks, through which savers can readily convert the proceeds of their savings into Belgian public securities;

(3) deposits on current accounts, made by certain public and private establishments at their own offices.

The available funds of provinces, communes, and public establishments in excess of their current needs are deposited in the Savings Bank.

The operations permitted the Savings Bank differ according to whether the part of the assets employed is

(1) destined for working funds,

(2) destined for temporary investments,

(3) destined for permanent investments.

In reality, the operations are carried out by the agency of the National Bank of Belgium with the guarantees of the Discount Bureaus. The working funds remain in the National Bank of Belgium. The temporary investments consist of discounts, advances on commercial paper, warrants and public securities.

"For permanent investments, the Bank can buy Belgian public securities, or those indorsed by the State, provincial or communal bonds, mortgage loans and the bonds of certain Belgian companies.

"The Bank is authorized also to advance funds for constructing workers' dwellings and to deal in mixed insurance operations, thus guaranteeing loans for the construction or purchase of workers' dwellings.

"Finally, it is permissible for it to use a part of its funds for agricultural loans, made either to the farmers themselves, or to coöperative societies for agricultural products." (P. Errera)

The profits serve to form a reserve fund. Every five years the government can decide that a portion of the reserve fund may be distributed to the bearers of passbooks.

At the close of 1927, the number of passbooks amounted to 4,266,753 and the total of deposits to 2,760 million francs.

THE POSTAL CHECK IN BELGIUM. We shall not dwell here on the merits of the postal check, and we shall not engage in theoretical discussion of the matter.

In Belgium, the budgetary law of December 28, 1912, established a postal check and clearing-house service which began to operate April 16, 1913. It is a service of the Postal Department; the central bureau is in Brussels, and the relations of the public with the service are maintained through the post offices of the whole country. The opening of an account is made on demand, the deposit of a small security being required. The deposits do not yield interest.

Operations were suspended during the war and resumed January 2, 1919. May 20, 1919, the tax of .10 francs per payment was repealed. A royal decree of September 10, 1919, ordered all the State's purveyors and the companies subsidized by the State to open an account in a bank or postal check office. March 23, 1920 a new royal decree provided that in the future the transactions of the State would be reimbursed by entry to the current account of the creditor in the National Bank, a bank belonging to the clearing house, or in the postal check service, and a law May 17, 1920 authorized the administration to open accounts officially with its dealers and employees. The law on the State's accounting was consequently modified. The government has carried on active propaganda for the postal check account, which has received the adherence of the public. But small customers are still to be won over, the postal check service being chiefly used, along with the current accounts of the banks, by large and moderate-sized businesses.

The Minister of Finance controls the operations of the postal check service; the profits realized cover the expenses of the service which exceed the returns from the very small duties levied on the transactions, and the surplus from the receipts is the direct profit of the Treasury. In December 1927 the number of accounts opened amounted to 205,666 and the total of deposits was as high as 1,279 million francs.

The Credit Unions. The organic law regulating commercial associations provides a special mode of establishment for companies having the object of procuring capital for their members by means of discount. This is the *Credit Union,* a sort of credit mutual which, at one period, was very popular with theorists of the socialist school: Guillaume De Greef, Hector Denis, etc. They saw in it a means of making credit operations democratic, and of resting the financial system of the country on local organizations, giving birth to regional associations, which, in turn, resorted to rediscount at the central bank.

The Credit Union, of course, is a society of persons, with the purpose of insuring its adherents favorable terms for discounting their commercial paper. In the course of its practice, the Credit Union can admit or exclude members, or accept their resignation.

The Credit Union naturally resorts to rediscount, and it can almost be said that it is a discount bureau in the coöperative or mutual form. This institution is evidently for the use of small businesses which would find it less easy to have their paper discounted at the ordinary banks.

Before 1922, there were five Credit Unions in Brussels, Charleroi, Liége, Mons and Verviers. Since then, two unions have been transformed into banks on shares. At that time the five Unions had 8,793 members, and had discounted 602,000 bills of exchange for a total sum of 920 million francs. The average amount of each bill is then 1,650 francs, indicating clearly that the Credit Unions are intended for small business.

CONCLUSIONS

We believe that the tendencies of the Belgian banking world are apparent from the preceding study. However, we think it useful to define them as they are revealed to our observation.

In a general way, commerce in credit in Belgium appears healthy, strong and alive. Few scandals are found there, and public opinion was not, until recently, alarmed over the power of the big credit establishments, with the exception of the members of the Belgian Labor Party, whose attacks are generally rather mild.

The Belgian banking world comprises extremely diverse, rather than specialized bodies. The Central Bank is solid and conservative; it possesses the means of regulating the exchange rate, practicing rediscount, and, at the same time, favoring moderate sized business directly. The importance of its exchange operations is rapidly superseding that of its commercial transactions. Such is the fate of many central banks in different countries.

Very powerful banks, governmental or those resulting from private initiative reach all classes of society.

If an attempt is made to formulate an opinion on the tendency of the Belgian banks, great embarrassment results: if our system is compared with that of American banks, numerous and isolated, Belgium may be deemed to exhibit intense banking concentration. If, on the other hand, Belgium is compared with Great Britain, France and Germany, it is seen immediately what a distance remains to be traveled in this direction. But it is undeniable that, in the last ten years, the Belgian banks by different processes tend to centralization. The " mushroom banks," such as spring up in any inflation, may have been deceiving, and may have led the superficial observer into error as to the direction of the movement, but the monetary stabilization has restored its veritable significance, as, moreover, it impels to concentration in all branches of industry.

No specialization tends to appear: the banks and their customers appreciate the multiplicity of operations: *varietas delectat.* The customer finds it convenient to go to a bank for all his financial transactions; the latter comes to know the customer's situation thoroughly, and therefore can exercise a control and direct his investments. It does not seem possible to arrive at specialization, particularly since the banks are more and more seeking industrial operations.

One of the most serious faults of the Belgian banks is their inertia in regard to overseas expansion, except in the Colony. Here likewise a slow, but favorable development is apparent. The question has even come up of creating an insurance-credit company of a nature to facilitate for banks the spreading practice of " confirmed credits " for the exportation business.

The absence of legislation relative to the banks, and especially the stock exchange brokers, whose activity often encroaches on

the banking domain proper, concerns a part of enlightened opinion. It is beginning to be understood that the administration of an important enterprise is a social public function as well as a private task. But an excessive reaction is to be feared, lest it lead to a meddling, vexatious and sometimes demagogic control. It seems, however, in conformity with the most sound theories of credit, that there is room for the voluntary establishment of a banking consortium with a moral influence on the profession, which could induce the banks to publish their condition periodically, for example every month, as in England, France and Germany.

The legislators should perhaps develop regulations governing the amount of deposits received and their employment; they might also fix a minimum capital for the founding of banks, and confer a legal mission of control on the Central Bank. But it does not seem that they ought to interfere in the questions of investments, "chains," agencies, credit methods, etc. In reality, there would be a question only of regulating deposits as the cover for bank notes has been regulated, and preventing the founding of companies with too weak capital, which almost always come to a lamentable end.

As for the regulation of the profession of stock broker, the question is urgent, but too complicated to be dealt with here.

The reader may reproach us with having insisted too much, in his opinion, on facts he may consider unimportant. But we have tried, above all, to give an exact idea of the banking situation in Belgium, and it will be understood that we have had to dwell chiefly on questions that have an importance for this country — local perhaps — but which contribute, for that very reason, in imparting to the Belgian market its individual character.

NATIONAL BANK OF BELGIUM

Sums Allotted Annually to the Treasury since the Organization of the Bank

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A. *From 1851 to 1872*

1. 1/6 of the annual net profits in excess of 6% of the company's capital (Article 7 of the law of May 5, 1850);

2. *after 1865,* the profit to the National Bank resulting from the difference between the legal interest (6% in commercial matters) and the interest rate charged by that institution is allotted to the public Treasury;

3. *after 1871,* the Bank is to pay the State a tax of 175,000 francs a year to " defray the expenses of the Treasury in the provinces."

B. *From 1873 to 1899*

1. 1/4 of the profits in excess of 6% of the paid in capital;

2. 0.25% the half year of the average amount of the note circulation in excess of 275,000,000 francs;

3. the profit resulting from the difference between an interest of 5% and the interest rate charged by the Bank;

4. to defray the expenses of the Treasury in the provinces, the amount of 175,000 francs a year.

C. *From 1900 to 1926*

1. 1/4 of the profits in excess of 4% of the paid in capital;

2. 0.25% every half year on the amount of the average note circulation in excess of 275,000,000 francs;

3. the profit resulting from the difference between an interest of 3.50% and the interest rate charged by the Bank.

4. to defray the expenses of the Treasury in the provinces, the amount of 230,000 francs a year.

(An agreement dated July 19, 1919 limited the basis of the tax provided for in *2* above to the average productive note circulation.)

D. *After October 25, 1926*

(a) by application of the royal decree of October 25, 1926, prolonging the duration of the National Bank of Belgium:

1. 3/5 of the net annual profits remaining after the deduction of the first dividend of 6% to the stockholders, and of the share of the surplus added to the share of the staff (10% + 6% of the remainder);

2. the profit to the Bank resulting from the difference between an interest of 3½% and the interest rate charged on discount and loan operations, foreign as well as domestic;

(b) by application of the Agreement of October 18, 1926 between the State and the National Bank in regard to the monetary stabilization:

3. the Treasury receives the income from placing the securities of the loan contracted by the State abroad to accomplish the stabilization of the franc, and turned over to the Bank by the State;

4. the Bank renounces, for the profit of the State, the income from placing foreign securities that shall be entered into the account in order to establish the proportion between the reserve and the demand liabilities;

5. any decrease of the securities mentioned under *3* that is not compensated for by a reduction of the amount of the demand liabilities or an increase of the gold-reserve shall oblige the Bank to pay a duty of 2.25 per cent to the Treasury.

STAMP DUTY ON THE CIRCULATION OF NOTES PAYABLE TO THE BEARER

(a) The law of July 20, 1848 prescribed for "negotiable commercial bills, *non-negotiable* notes or bonds, and time or place to place money orders" a stamp tax in the proportion of 0.50 francs per 1,000 payable at the time the certificate is created;

(b) the law of September 10, 1862 modified the manner of levying the tax while preserving the percentage: " the duty established on notes to the bearer shall no longer be collected before the issue of the certificates. The subscriber shall pay, at the end of each year, a duty of 0.50 francs per 1,000 of the average amount of notes kept in circulation during the year."

(c) the Agreement of July 19, 1919 (withdrawal of the German marks) limited the taxable basis of the stamp duty to the average *productive* circulation (exclusive of the circulation corresponding to advances made to the State);

(d) *after September 1, 1920,* the stamp duty on the average note circulation is *doubled* (1 per thousand);

(e) *after April 1, 1926,* the duty is raised to 0.60 per thousand every half year, that is, 1.20 per thousand a year, on the average productive circulation;

(f) *after October 26, 1926,* the stamp duty of 0.60 per thousand the half year is calculated on the average note circulation, deduction having been made of the average amounts of the gold-reserve, the credit balances in foreign exchange and the debt of the State.

CHAPTER V

THE BANKING SYSTEM OF CANADA

BY

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PREFATORY NOTE

The writer desires to acknowledge the very great indebtedness due Mr. H. C. McLeod, at one time General Manager of the Bank of Nova Scotia, who placed at the author's disposal his voluminous accumulations and writings on the Canadian banking system and so generously and unsparingly gave of his time and strength. In fact so important were Mr. McLeod's contributions, that the writer suggested that he become a joint author of the chapter and had Mr. McLeod lived to make this possible, the monograph would have been greatly enriched. As it was he prepared the table appearing on pp. 334–337 which he considered in preliminary form but which contains much information not elsewhere available.

The chapter has been read with minute care by the following persons who have made innumerable suggestions of the utmost value in whipping it into final shape:

Mr. H. V. Cann, a retired banker and a close associate of Mr. McLeod.

Mr. J. Courtland Elliott, Canadian Economist, formerly with the Division of Research and Statistics, Federal Reserve Board, Washington.

Mr. W. A. Mitchell, formerly with the Royal Bank of Canada.

In addition, Mr. H. M. Cameron, now with the McGraw-Hill publications, New York City, has given much of his time and energy, and has drawn on his deep experience and knowledge of the financial organization of Canada.

In the statistical and other phases of the work, the writer has had the assistance of Mr. Richard H. Garlock, Miss Margaret G. Myers,

[1] Assistant Professor of Banking, School of Business, Columbia University.

Mrs. Marion Andrews Upgren, Mr. Donald Marvin, and Mr. H. E. Cooper.

Then he wishes to express his appreciation for the courtesies shown by the *Monetary Times* (Toronto), the officials in the chartered banks and the Canadian Government for the patience and thoroughness shown in answering his many and, no doubt troublesome, inquiries.

Those to whom acknowledgments are due and to whom they have been given are not to be held accountable for any errors which may be found or for opinions expressed, for which the writer is alone responsible. In fact, in many instances the collaborators neither agreed with the writer nor among themselves as to generalizations made or opinions held.

ADDENDUM

On July 13, 1928 the approval of the Minister of Finance was given for the Canadian Bank of Commerce to absorb the Standard Bank of Canada, issuing one share of its own for each share of the Standard Bank. With this absorption, there are 10 chartered banks in the Dominion.

THE MONETARY, CREDIT AND BANKING ORGANIZATION OF CANADA

The Canadian banking system offers a puzzling contrast to the business man and banker in the United States, accustomed as each is to the unit type of bank, organized under the widely varying laws of forty-eight different states or of the Federal Government. To one accustomed to such a system the most striking difference, and the feature observed first, is the small number of banks, all operating under Dominion law, each with tens and hundreds of branches scattered across the continent. Not that branch banking is unknown to business men in the United States,[2] for in some states, particularly in California, where the law permits, it has within recent years reached a high stage of development, but the typical American bank is the unit institution, operating without branches and with relatively small resources, and catering to the agricultural and business interests of a single locality. Other differences, less spectacular but as real, appear in the absence in Canada of a central reserve bank and of any

[2] For a study of branch banking in the United States, see report filed by Dr. H. Parker Willis of Columbia University with the Banking and Currency Committee of the United States Senate in February, 1926.

organized money market such as a call loan,[3] a discount, or a commercial paper market. These contrasts, basic and fundamental as they are, existing in the financial organization of two countries similar in economic life, resources and people, make the Canadian banking system of the utmost importance and fascination to the American student, interested as he now is in the problems of branch banking and the many baffling problems involved in the relationship between the type of banking system and the economic development of a nation.

THE MONETARY AND CREDIT SYSTEM OF CANADA. Before discussing the many absorbing questions involved in the banking organization of Canada, its monetary and credit structures will be briefly treated. These are very similar and closely allied to those of the United States. The economic interdependence of the two nations, the intimacy of trade and financial ties, make this natural and inevitable. Of the important self-governing dominions, Canada, with the exception of Newfoundland, alone fails to use the £ as the standard of value, the currency unit or medium of exchange. Economic affiliations with her neighbor to the south have been strong enough to bring about the use of the American dollar as the basis of Canadian currency, even though, as a matter of form, the sovereign (but not the £ sterling) has been given the legal tender power.

The monetary system was given legal sanction by the Uniform Currency Act of 1871, which made the British sovereign legal tender for $4.86-2/3 and the United States eagle for $10.[4] Authority was also given for the coinage of a Canadian $5 gold piece, but no gold coins were issued prior to the establishment at Ottawa in 1908 of a branch of the Royal Mint. Through these years there was little need for domestic gold coinage, as Canadians preferred to use paper money in the form of Dominion notes or of the

[3] While the call loans in connection with the Montreal and to a lesser extent with the Toronto Stock Exchanges have reached large totals for a generation or more, these loans are not as "callable" or realizable as are the call loans in New York.

[4] In 1853 a measure had been passed providing for the adoption of a decimal currency based on the American dollar. Beginning with January 1, 1858, all Government accounts, by an act approved the previous year, have been kept in dollars and cents. *The Canada Year Book,* 1924, p. 785. In 1910 American gold coins of $5 and $20 in denomination were given the legal tender power. See Currency Act, 1910, 9–10, Edw. VII, c. 14, s. 9–10.

notes of the chartered banks. The gold required for export or for the till money of banks consisted either of gold bars or of the gold coins of England or the United States.[5]

Beginning in 1908 the Canadian mint finally began to issue gold sovereigns and in May, 1912, under authority granted in 1910, the first $5 and $10 Canadian gold pieces were coined.[6]

Fractional currency is issued in denominations of fifty, twenty-five, ten, and five-cent silver pieces, and bronze pennies (cents or coppers). Since 1921 five-cent nickel pieces have been added. The standard of fineness of silver coins is 8/10 and their weight is equal proportionately to their respective fractions of the silver dollar, none of which have been issued, but which have a legal weight of 360 grains. Silver coins are legal tender to $10, nickel to $5, and bronze to 25 cents.[7]

Paper Money. Though Canada legalized gold as a standard of value soon after confederation, paper money, either in the form of notes of the Dominion Government or of those of the chartered banks, serves as the hand to hand currency. Dominion notes, secured in part by gold and in part by approved securities, do not circulate widely excepting in the case of paper money of less than $5 in denomination which consists entirely of Dominion notes. Dominion notes are used principally for the settlement of clearing house balances, or for the expansion of the bank note currency.[8] They were first issued by an act passed in 1868, which gave authority for an amount up to $8,000,000 not entirely covered by gold. From time to time amendments were passed, raising the amount of the uncovered issue. A digest of this legislation follows:

[5] See *Interviews on the Banking and Currency Systems of Canada*, pp. 53 and 158.

[6] *Fifty-Fifth Annual Report of the Deputy Master and Comptroller of the Royal Mint, 1924*, p. 126.

[7] *Fifty-Fifth Annual Report of the Deputy Master and Comptroller of the Royal Mint, 1924*, pp. 127–128.

[8] See pp. 385–401 for a further discussion.

Date of Act	Amount of Dominion notes permitted, not entirely covered by gold	Gold Reserve Requirements
1868 (31 Vict., c. 46)	$8,000,000	Reserve fixed at 20% in case circulation did not exceed $5,000,000; 25% reserve against circulation from $5,000,000 to $8,000,000.
1870 (33 Vict., c. 10)	9,000,000	Reserve fixed at 20%, but the $9,000,000 were to be issued only when reserve amounted to $2,000,000. Any amount issued in excess of $9,000,000 was to be entirely covered by gold.
1872 (35 Vict., c. 7)		The law of 1870 was amended fixing the reserve against the circulation issued in excess of $9,000,000 at 35%.
1875 (38 Vict., c. 5)		The laws of 1870 and 1872 were amended so as to require a reserve of 50% in specie for circulation between $9,000,000 and $12,000,000, and a reserve of 100% for circulation issued in excess of $12,000,000.
1880 (43 Vict., c. 13)	20,000,000	Reserve of 25% in gold and guaranteed debentures of which at least 15% was to be in gold.
1895 (58–59 Vict., c. 16)		Authority was given for the issuance of any amount above $20,000,000 provided it were secured entirely by gold.
1903 (3 Edw. VII, c. 43)	30,000,000	The Minister of Finance was required to hold gold and guaranteed debentures of not less than 25% against Dominion notes issued and outstanding up to $30,000,000; beyond that they were to be secured entirely by gold.
1914 (5 Geo. V., c. 4)	50,000,000	The Dominion Government was given authority to issue notes up to and including $50,000,000 against which a gold reserve of 25% had to be maintained.

1914 (5 Geo. V., c. 3) (See Finance Act, 1923)		The Finance Act, 1914, made provision, in case of war, panic, etc., for the issue of Dominion notes against certain approved securities.
1915 (Chap. 4)	76,000,000	The Dominion Government was allowed to issue notes up to $26,000,000 without any reserve of gold, of which $16,000,000 were to be secured by certain specified railway securities guaranteed by the Dominion Government. Notes issued in excess of $76,000,000 were to be secured dollar for dollar by gold except as provided in the Finance Act of 1914.
1923 (Chap. 48)		The Minister of Finance may make advances by the issue of Dominion notes to the banks upon the pledge of Government securities, Canadian municipal securities, promissory notes and bills of exchange secured by documentary title to grain, etc., and promissory notes and bills of exchange issued or drawn for agricultural, industrial or commercial purposes.

After the outbreak of the war, it will be observed that the legal limits of the Dominion note circulation had been increased to $50,000,000, against which a gold reserve of 25% had to be maintained.[9] At that time there were $114,182,098 of Dominion notes in circulation,[10] of which $92,663,575 were fully covered by specie. Later legislation was passed which permitted the fiduciary issue to expand more or less indefinitely,[11] within the limits of

[9] See pp. 387–401 for a further discussion.

[10] Including a few unredeemed Provincial notes which had become a liability of the Dominion.

[11] The situation existing there revealed a weakness in the Canadian bank note in that it seemed unable to expand to meet a war demand for currency. Were there a central rediscounting bank, operating along lines of the Bank of France or the Federal Reserve Banks, which were empowered to coin commercial paper into bank notes, this situation could have been met.

acceptable securities. This step, along with certain others, was deemed necessary by the heavy withdrawals of gold from the banks on the part of depositors hysterically trying to protect their interests. After due consultation with the bankers, an Order-in-Council was made public on the morning of August 4, permitting advances [12] of Dominion notes, to the chartered banks against the pledge of securities deposited with the Ministry of Finance. As a further precaution the banks were empowered to make payments in their own notes, though they had not previously possessed the legal tender power under the existing laws, and the banks were also granted the privilege of issuing the excess bank note circulation previously confined to the crop-moving period throughout the entire year. The amount of bank notes outstanding were not at any time to exceed the amounts authorized by the existing laws. The Order-in-Council, later given legislative sanction by The Finance Act, 1914, allowed for inflation in Canada incident to the financing of the war in much the same fashion as was followed in England with the Bradburies or currency notes. From an amount equal in 1914 to $115,000,000, the Dominion notes increased rapidly, reaching a peak of $337,000,000 on November 30, 1919. Since then, as shown in the table at the top of page 296, the amount outstanding has declined by nearly $100,000,000.[13]

While the amount of Dominion notes outstanding is large, these are mainly used in inter-bank transactions, and it is the bank notes of the chartered banks themselves which are universally used as the medium of exchange in denominations of $5 and above and constitute the " M " of Professor Fisher's famous equation of exchange. A more detailed discussion of the bank notes occurs later.[14]

THE CREDIT SYSTEM. As in the case of the monetary system, the credit system of Canada, developing from Scottish and British origins as did that of the United States, offers no striking peculiarities to the American student. The open-book account, the promissory note, the trade acceptance are used in the financing

[12] Originally it was stipulated that such advances were to be repayable not later than May 1, 1915, with interest at a rate to be approved by the Minister of Finance but not less than 5% per annum.

[13] Further details of the War Finance Act are given in a later section, pp. 387–401. Data for table may be found in the *Canada Year Book, 1925*, pp. 821–822.

[14] See pp. 375–385.

— DOMINION NOTE CIRCULATION AND RESERVES AT JUNE 30, 1890–1926.

Years ended June 30	Notes in circulation					Reserves of specie	Circulation uncovered by specie[18]	Percentage of specie reserve to circulation
	Notes 1, 2, 4 and 5, and fractionals[15]	Large notes, 50, 100, 500, 1000, 5000[16]	Total					
			Amount	Per capita	Index No.[17]			
	$	$	$	$		$	$	p.c.
1890	6,665,942	8,691,950	15,357,892	3.20	65.3	3,285,515	10,125,711	21
1891	6,768,666	9,407,650	16,176,316	3.34	68.2	3,887,027	10,452,623	24
1892	6,898,348	10,384,350	17,282,698	3.53	72.0	5,061,577	10,414,455	29
1893	7,136,743	11,311,750	18,448,493	3.73	76.1	6,449,348	10,052,479	35
1894	6,967,818	13,093,900	20,061,718	4.09	83.5	8,292,405	9,822,647	41
1895	7,059,331	12,460,900	19,520,231	3.87	79.0	7,761,084	9,812,481	40
1896	7,377,096	12,995,100	20,372,196	4.00	81.6	8,758,252	9,667,295	43
1897	7,519,345	14,798,750	22,318,095	4.34	88.6	10,723,649	9,650,780	48
1898	8,157,243	14,020,950	22,178,193	4.26	86.9	10,813,739	9,417,788	49
1899	8,770,165	15,466,300	24,236,465	4.60	93.9	13,061,775	9,228,024	54
1900	9,640,473	16,454,450	26,094,923	4.90	100.0	12,476,044	11,672,213	48
1901	10,161,809	17,736,700	27,898,509	5.19	105.9	14,578,117	11,394,769	52
1902	11,029,985	21,750,400	32,780,385	5.92	120.8	18,901,639	11,932,080	58
1903	12,173,248	26,832,950	39,006,198	6.87	140.2	25,930,594	11,128,938	66
1904	12,581,833	28,992,950	41,574,783	7.13	145.5	23,422,625	16,205,492	56
1905	13,045,820	34,288,400	47,334,220	7.89	161.0	28,890,837	16,062,098	61
1906	14,633,576	35,307,850	49,941,426	8.09	165.1	29,013,931	18,980,829	58
1907	15,939,131	42,377,400	58,316,531	9.25	188.7	34,989,270	21,380,595	60
1908	15,279,675	47,778,450	63,058,125	9.71	198.2	39,141,184	21,950,275	62
1909	15,860,149	63,145,150	79,005,299	11.80	240.8	55,363,266	21,695,367	70
1910	17,871,477	71,414,250	89,285,727	12.90	263.3	66,409,121	20,929,940	74
1911	19,840,695	79,468,250	99,308,945	13.78	281.2	78,005,231	21,303,714	78
1912	22,982,588	88,949,650	111,932,238	15.19	310.0	92,442,098	19,490,140	82
1913	28,845,737	87,517,800	116,363,537	15.45	315.3	94,943,499	21,420,038	81
1914	24,586,448	89,595,650	114,182,098	14.84	302.8	92,663,575	21,518,523	81
1915	25,183,685	126,937,050	152,120,735	19.34	394.7	89,573,041	62,547,693	59
1916	27,283,425	148,213,750	175,497,175	21.84	445.7	114,071,032	61,426,143	66
1917	29,498,409	149,069,600	178,568,009	21.82	445.3	119,110,113	59,457,896	67
1918	32,623,514	248,716,000	281,339,514	33.78	689.4	114,951,618	166,387,896	41
1919	35,084,194	265,665,650	300,749,844	35.47	723.9	118,268,407	182,481,437	39
1920	37,203,890	254,812,400	292,016,290	33.83	690.4	95,538,190	196,478,100	33
1921	34,403,934	234,365,250	268,769,184	30.58	624.1	83,854,487	184,914,697	31
1922	31,404,161	201,344,250	232,748,411	25.96	529.8	85,495,068	147,253,343	37
1923	33,276,533	200,869,000	234,146,433	25.60	522.4	121,025,725	113,120,708	52
1924	34,816,442	175,492,150	210,308,592	22.54	460.0	96,732,954	113,575,638	46
1925	32,294,827	176,096,650	208,391,477	22.25	454.1	116,263,994	92,127,483	56
1926	32,512,285	143,200,630	175,712,915	18.49	377.4	94,999,481	80,713,434	54

[15] Includes Provincial notes amounting to $32,857 in 1890 and reduced gradually to $27,687 in 1925.

[16] Includes issue of $50,000 notes, 1919–1925.

[17] Per capita circulation in 1900 is taken as 100.

[18] The circulation uncovered by specie reserve was to a considerable extent covered between 1890 and 1910 by the holdings of guaranteed debentures, amounting to $1,946,666. Since 1914 it has been covered in the main by the holding against it of approved securities. On June 30, 1925, the Dominion notes outstanding against securities, approved under the Finance Act, 1914, and amendments, and c. 4 of the Statutes of 1915, amounted to no less than $77,200,000.

of domestic trade, and the bankers' acceptance in the financing of foreign. The over-draft is used to some extent, principally for temporary requirements, but not at all so widely as in England.[19] Its use is discouraged by the banks as much as possible. The trade acceptance is rather extensively used as between wholesalers and retailers. In fact it is the general practice for retail purchasers to give the wholesaler trade acceptances for their obligations, which the latter then indorses and discounts with his bank. Open-accounts are not so general in Canada as in the United States. Advances are also made upon the discounting of promissory notes, with or without security, and to a certain extent upon the assignment of accounts receivable,[20] subject to the legislation governing these in the several Provinces. The bankers' acceptance is confined entirely to foreign trade. Since there is no market for acceptances in Canada, the letters of credit issued by the chartered banks invariably provide for drawings upon their London or New York offices. Finally, and this practice in Canada is unlike that followed in the United States, the business man there deals with only one bank except in the case of very large corporations and stock exchange brokers. The banker gets to know his customer's affairs intimately and is in a most strategic position to advise and assist him.

THE FINANCIAL ORGANIZATION. The issuance of bank notes and the commercial banking functions of Canada's financial organization are in the hands of the ten chartered banks, which operate under the law of the Dominion to which the British North America Act gave exclusive authority in all matters pertaining to the regulation of the currency and coinage, banking, and the issuance of paper money. Provincial legislative bodies were estopped by this from the creation or incorporation of banks of discount and deposit.[21]

[19] Until within recent years it was widely used, but banks have been discouraging this form of borrowing and have been educating their customers to the use of promissory notes.

[20] Accounts receivable are not looked upon with favor as security by banks.

[21] Unless authorized by the Dominion no individual or corporation may use the word "bank" in the title of its business, nor may the chartered banks advertise as a savings bank though they may advertise they have such a department.

The first bank act of the Dominion was passed in 1871, under the terms of which the 28 banks [22] then in operation were reincorporated. Of these, 18 had been chartered by Upper and Lower Canada (thereafter divided into Ontario and Quebec), 5 by Nova Scotia, 4 by New Brunswick, and 1 operated under royal charter. As the charters are granted for but ten-year periods, the act is revised decennially. Such revisions have taken place in 1881, 1891, 1901, 1913, and 1923. Important amendments were adopted in 1908 and 1924.

Origin of Canada's Banking System. The branch banking system of Canada with its asset-secured bank notes, made permanent by the Act of 1871, was not adopted without a struggle. There were those who favored the adoption of the unit type of bank as provided for in the National Bank Act of the United States, issuing notes secured by government bonds. A reason for proposing the American system was the failure of two large Canadian banks, occurring about the time of the adoption of the National Bank Act. Shortly after the adoption of the British North America Act by the Imperial Parliament, E. H. King, General Manager of the Bank of Montreal, gave considerable impetus to the movement favoring the adoption of the bond-secured bank note. He strongly recommended the establishment of independent local banks issuing notes based on Dominion securities deposited with the Receiver-General.[23] Banks so organized were to hold a fixed minimum reserve of specie or Dominion notes against deposits. These views were shared by Thomas Paton, the Canadian representative of the Bank of British North America, and were indorsed by Sir John Rose, then Minister of Finance. The views of this group were embodied in a series of resolutions

[22] Breckenridge, *The History of Banking in Canada* (National Monetary Commission), p. 89.

[23] See, Adam Shortt, *The Banking System of Canada,* pp. 627–628 in *Canada and Its Provinces,* Vol. x.

" Mr. King favored a system of banking under which the note circulation of the banks should be entirely based upon government securities, and the Bank, which was benefiting by large deposits from the United States, and which had been appointed the Financial Agent of the Province, increased its holdings in government securities, so that they amounted in 1868 to upwards of $4,000,000," — p. 45, *The Centenary of the Bank of Montreal, 1817–1917,* Head Office, Montreal, Canada, 1917. See also *The Monetary Times,* Vol. 2, p. 584 (April 29, 1869) and Vol. 7, p. 1334.

which Rose laid before Parliament on May 14, 1869, and which were utilized to serve as the basis for the first bank act. In the speeches defending his proposals, he laid particular emphasis on the need of a sound bank-note currency of a uniform value over the Dominion. The notes were commonly payable at the place or office issued, and did not necessarily circulate at par elsewhere. However much inconvenience resulted, this was but a minor defect subject to easy rectification. For the sake of correcting this, Canadians were quite unwilling to part with the real essential advantages of their banking and currency system by adopting one so inherently defective.

Committees of the new Dominion Parliament had been appointed, in the meanwhile, to study the many problems involved in the establishment of a banking and currency system. The first report of the Select Committee on Banking and Currency of the House, issued in the session of 1868–1869, consisted simply of a questionnaire relative to the advisability of introducing the American system, and of the replies received, which had been sent to bankers, merchants and other persons prominent in the life of Canada.[24] The weight of the evidence strongly opposed further issues of Government money, or issues of bank notes based on specific security, or the establishment of small local banks. It was held that the introduction of the National Banking System of the United States would have the effect of greatly increasing the cost of bank-note issue, which would bear with particular severity on the agricultural communities,[25] and would give Canada a currency inadequately responsive to trade needs. Agricultural credits would probably be curtailed as a result, and the number of offices in the country districts reduced.

Not daunted by these replies, the banking committee of the House, of which Rose was chairman, presented in May, 1869, resolutions calling for the adoption of measures embodying the essentials of the National Bank Act. This met with a storm of protest. Canadians were too well satisfied and pleased with their branch banks, possessed of the right of issuing an asset bank-note currency, to have substituted a generally acknowledged inferior

[24] The questionnaire may be found in the *Journals of the House of Commons*, November 6, 1867 — May 22, 1868, Appendix No. 9.

[25] See Breckenridge, *The History of Banking in Canada*, pp. 92–93.

system, composed of small local institutions, with a government-bond-secured inelastic note issue. The concensus of opinion favored the continuation by Dominion law of the banking system existing up to then under Provincial law. Over seventy petitions were received opposing the proposals of the Committee, from boards of trade, the leading cities and towns, and from ten of the banks.[26] Support for the American plan of banking was given by representatives from New Brunswick and southern Nova Scotia and, of course, by the Bank of Montreal and by the Bank of British North America. The banks of Halifax, and of the Provinces of Quebec, Ontario, and Western Canada were strongly opposed. But a single day (June 1, 1869) was devoted to the proposals submitted by the committee to the House. So intense grew the hostility that Rose was forced to relinquish his portfolio in the Cabinet.[27] At about this same time King retired from the active management of the Bank of Montreal. All prospects therefore of recasting the Canadian banking structure along American lines vanished. Canada had made a definite and clear-cut decision not to have small local branchless banks.

As a successor to Sir John Rose, Sir Francis Hincks, who for fifteen years had been in British Colonial services and but lately returned to Canada, was selected as Minister of Finance by Sir John A. Macdonald. After numerous conferences with bankers, merchants, publicists and others, and after a careful study of existing legislation, Sir Francis formulated measures which introduced no radical departure from the existing system. The proposed legislation, establishing the banking policies of the country, was enacted in 1870 (33 Vict. c. 11), and in the following year was consolidated with much of the previous banking legislation,[28] into the first general bank act.

Bank Act of 1871. The Bank Act of 1871 fixed the minimum capital of the chartered banks at $500,000, of which at least

[26] See p. 94, *Journals of the House of Commons of Canada,* from April 15 to June 22, 1869 and p. 15 of the index.

[27] Breckenridge, *The History of Banking in Canada,* p. 98.

[28] During the first session of the Dominion Parliament, a general Act (31 Vict. 1867, c. XI) was passed authorizing all banks incorporated by any of the provinces which were now included in the Dominion of Canada to open branches and do business throughout the Dominion. (Ross, *The History of the Canadian Bank of Commerce,* Vol. II, p. 438.)

$100,000 must be paid in (within two years another $100,000 must have been paid in) before a bank might undertake business under a certificate from the Treasury Board. This requirement of subscribed stock, which bore double liability, would be equal in purchasing power at the present time to at least $1,000,000 and was thought sufficiently large at the time to exclude those without sufficient financial responsibility from undertaking the responsibilities and from sharing in the privileges of the banking fraternity. The note issues were limited to the amount of their paid-up capital, and were to be redeemed at the head office in gold coin or Dominion notes. Dividends in any form were limited to 8% per annum until a surplus account (rest) had been accumulated equal to 20% of the paid-up capital. Of such cash reserves against deposits as were maintained, not less than 33⅓% and if possible 50% were to consist of Dominion notes. Monthly returns under prescribed forms were to be sent to the Government and to be published in the official Gazette. The charters of the banks under this act were to expire in 1881. Through the adoption of this legislation Canada had perhaps the most elaborate and detailed banking code of the British Empire which definitely committed her to the policy of nation-wide branch banking, and to an asset-secured bank-note issue confined in total amount to the paid-up capital of the banks, and yet possessing sufficient elasticity then to respond to seasonal and cyclic movements.[29] It was the branch bank features which Sir Francis Hincks thought the most essential and valuable, for a nation of Canada's size, depending mainly on extractive industries, would increasingly rely on such a system in the production, distribution, and exportation of her products.[30] Such nation-wide and many-product financing would require banks of a large size and Sir Francis' first suggestion was a minimum capitalization of $1,000,000 which was, however, opposed by the friends of small banks, especially throughout the Maritime Provinces, and the capital actually provided for represented the utmost concession to his demands.

[29] See Adam Shortt, *The Banking System of Canada,* pp. 633–634.

[30] The underlying principles of this enactment may be traced back to the first Bank of the United States, which served as a model for the early financial institutions in Canada. Ross, *The History of the Canadian Bank of Commerce,* Vol. II, p. 389, and also see writings of Adam Shortt.

The revisions which occur decennially have on the whole improved the Act and have been drafted ordinarily in response to some defect revealed by the experience of years in the Act or in the banking organization. These frequent revisions have been of real advantage in preventing the act from becoming obsolete, in contrast to the policy followed in the United States, where reform in the National Bank Act comes not through periodic revisions but through the addition here and there of patch-like provisions which serve more to confuse and complicate the measure.

THE REVISION OF 1881. In the following paragraphs a brief résumé will be made of the changes introduced since 1871. The first revision, which became effective on July 1, 1881, did not materially alter the Act. The important changes were:

(1) The banks were restricted in their issue privilege to notes of $5 and multiples thereof which were given a prior lien on the assets of failed institutions.

(2) The proportion of Dominion notes required to be held by the banks was fixed at 40% of such cash reserves as they might choose to maintain.

(3) The monthly return was made fuller and more detailed as regards the financial relations of the banks with one another and as regards the classes of bonds held as investments.[31]

THE REVISION OF 1891. The bankers began to prepare as early as 1888 for the next revision which introduced changes of some real significance. One of the harassing problems was that arising from the discount on the notes of failed banks which in the case of the Maritime Bank had amounted to 60 per cent. The ultimate convertibility of notes was assured by the prior lien possessed by the holder, but before this could take place considerable delay and hardship was encountered by the note holder. In order to prevent this depreciation, the feeling was strong that the note holder should be paid as promptly as possible after the

[31] The question of government inspection or examination and of the compulsory appointment of auditors was discussed but did not materialize into any legislation.

suspension had taken place. Still another complaint arose from the fact that bank notes did not circulate at par in all parts of the country, but were subject to annoying discounts when offered for payment in places remote from the head office of the issuing banks. This defect was one of increasing importance with the growing inter-provincial trade. Then there were those, among whom was the Hon. George E. Foster, Minister of Finance, who proposed, as was required of banks in the United States, the maintenance of fixed minimum reserves, to the extent of 10% of liabilities, and others who urged the auditing of the banks' books by competent disinterested persons appointed by the shareholders who would present their reports to the Minister of Finance and the shareholders. The bank failures occurring in the eighties convinced some of the necessity of a more stringent supervision of the banks, of independent audits, and persuaded others of the desirability of the American bond-secured note issue. None of the provisions respecting reserves or audits or the adoption of the American note issue prevailed against the opposition and arguments of the bankers, especially of Mr. B. E. (later Sir Edmund) Walker. The note issue sections were, however, modified to insure the prompt redemption of the notes of failed banks by the insertion of the following provisions:

(1) A fund known as the Bank Circulation Redemption Fund was established to prevent the notes of failed banks from being quoted at a discount between the time of failure and redemption. As originally constituted this fund was to be built up from contributions by the chartered banks, equal in amount to 2½% of their average circulation in the year 1890–1891 and to a further 2½% in the year 1891–1892. Thereafter the fund was to be adjusted annually so that it would be equal to 5% of the average circulation during the twelve months preceding the 30th of June each year. The annual average was to be calculated upon the greatest amount outstanding during each month. No payment was to be made from the fund unless the liquidator of the insolvent institution should fail to make arrangements for the redemption of the note liabilities within two months of suspension. Directly upon the default of a

bank the notes were to bear interest at the rate of 6% per annum until such time as the liquidator published notice of his readiness to redeem.

(2) Furthermore, the banks were required to insure the redemption of their notes at par. For this purpose redemption agencies were to be established at Halifax, St. John, Charlottetown, Montreal, Toronto, Winnipeg, and Victoria.

(3) Another change incorporated in the act required the paid-up capital to equal $250,000 before a bank might open its doors. No notes were to be issued or business conducted until this amount of money had lain on deposit with the Minister of Finance for at least four weeks and such longer time as might elapse until the issue of a certificate by the Treasury Board. Within a year after the date of the charter a bank was required to secure the necessary capital and to comply with all the legal preliminaries to commencing business.

(4) Directors were henceforth to be required to be owners of a certain amount of paid-up rather than subscribed stock as a qualification for their holding office.

(5) The requirement that no dividends in excess of 8% per annum be paid until the surplus were equal to 20% of capital was raised to 30%.

(6) Another major change, suggested by Mr. Z. A. Lash on behalf of the Bankers' Section of the Toronto Board of Trade, gave the lending bank in certain loans the same legal power over the goods of the debtor as would have been granted by a warehouse receipt. This would permit the chartered banks to lend an amount to manufacturers and shippers for seasonal requirements much in excess of the amount which could prudently be extended on the basis of the firm's capital inasmuch as the bank had the additional protection of this secret lien.[32]

[32] See Ross, *History of the Canadian Bank of Commerce*, Vol. II, pp. 463–4.

THE REVISION OF 1901. The most important and far-reaching change introduced at the next revision was the official recognition given The Canadian Bankers' Association as an agency in the supervision and control of certain activities of the banks. This society had been organized in the early nineties and had proved of some importance to the member banks. A chief cause for the organization of the Association was the legislation at the preceding revision of 1891 under which the Bank Circulation Redemption Fund was established. All the banks are contributaries to this fund and in case of the failure of a bank and subsequent depletion of the fund, the remaining banks are obliged to restore the fund. Thus every bank has an interest in the regularity of the note issues of every other bank, and it was important that there should be some control by a properly authorized body of the printing and distribution of notes to the banks and their destruction. With a view of enabling it to act in a legal capacity, both on its own account and in connection with the Dominion Treasury Board, the Association was incorporated.

The provisions inserted in the act at this time intrusted the Bankers' Association with the following responsibilities: [33]

(1) Control over clearing houses under rules and regulations approved by the Treasury Board.

(2) The appointment of a curator to assume supervision of the affairs of suspended banks, with a view of protecting the interests of shareholders and depositors. The curator, so selected, was to administer the bank until it resumed operations or until a liquidator was appointed by the court in case the bank were unable to resume operations.

(3) Supervision of the printing and distributing of notes to the banks and their destruction.

In addition to this change, the Bank Act included provisions permitting one bank to sell its assets to another. More detailed monthly returns were required and the interest on the notes of failed banks was reduced from 6% to 5% in order to better adjust it to market conditions.

[33] For a further discussion see pp. 445–447.

Amendment of 1908. In order to permit an increase in circulation during the crop-moving period, the banks were granted permission to increase their circulation in the months of October, November, December, and January by an amount not to exceed 15% of the issuing bank's paid-up capital and surplus (rest or reserve fund). Such emergency circulation was to be taxed at a rate to be fixed by the Governor-in-Council but not to exceed 5% per annum. In 1912 this period was lengthened to include the months of September and February.

The Revision of 1913. The next general revision, which took place in 1913,[34] effected the following changes:

(1) Provision was made for a shareholders' audit by auditors chosen by the shareholders from a panel selected by The Canadian Bankers' Association and approved by the Minister of Finance.

(2) The central gold reserves were established.

(3) Additional facilities were provided for extending loans to farmers.

For several years there had been a demand for some sort of stockholders' audit or external inspection. The leader in this movement, and the one who aroused the nation to the need of such reform, was Mr. H. C. McLeod, then General Manager (in American banking parlance President) of The Bank of Nova Scotia and at one time an official of The Canadian Bankers' Association. In his address on January 26, 1910, before the Seventy-Eighth Annual General Meeting of Shareholders of his bank, he spoke in part as follows regarding the necessity for such supervision:

". . . I deemed it a duty to the Bank, as well as to the public, to make the subject of external examination of banks a live issue before the revision of the Bank Act is undertaken in Parliament.

[34] The revision had been postponed from 1911 due to the negotiations then taking place with the United States relative to a reciprocity treaty. The Government of the day was defeated and, in 1912, the new ministry requested and received another year's delay which it thought was justified in view of the many responsibilities it faced.

In this I am gratified to have the hearty support of my fellow Directors, and to all appearances, the almost unanimous approval of the shareholders, many of whom have expressed strong views in its favor. . . .

" The public has taken more interest than we hoped for at a time when topics of the greatest national import were absorbing attention. . . . But I am not satisfied with banking conditions in Canada, and I am apprehensive of the results that will follow the period of fresh inflation of bank credit on which Canada has just entered. . . . A well-informed banker has announced in words that cannot be mistaken, in regard to his authority to speak for the Government, that there is not likely to be any important change in the Bank Act. . . . All the members of The Canadian Bankers' Association are opposed to changes that I have urged with the object of doing away with secretive management, and they suggest no other remedy for the demonstrated weakness of our system.[35]

The disastrous failure of the Farmers' Bank which had gambled away its resources on the Keeley mine, together with the crusading work carried on by Mr. McLeod, crystallized public sentiment in favor of some form of bank supervision. Powerless to stem the tide, the bankers, who had previously been supported by the Government, withdrew their opposition.

The provisions in the act respecting the central gold reserves made it possible for a bank to issue as many of its notes as it pleased provided equivalent deposits in gold or Dominion notes were made with the Trustees of the Central Gold Reserves. This section, which had been advocated for some time, will be discussed at a later point.[36] The third important change was the power given to banks to make loans to farmers on grain stored on the farm and still in the farmers' possession.

The Revision of 1923. Economic conditions in Canada in 1923, the year of the last revision, made it certain that serious attempts would be made to alter in a radical fashion the banking system. The farmers were passing through a severe and heart-rending readjustment initiated by the fall in the general level of

[35] *Seventy-Eighth Annual Report,* Bank of Nova Scotia, pp. 20 and 23.
[36] See pp. 385–387.

prices three years previously and intensified by the relatively low prices prevailing for their products as compared with the commodities and goods they were forced to purchase. The farmers, discontented and rebellious, were represented by a fairly strong agrarian party (Progressive Party), which occupied a most strategic position in that it held the balance of power as between the Liberal and Conservative Parties. Some of its members were quite firmly convinced that the banking system was diabolically responsible for the economic maladjustments in which the farmers had become enmeshed. Then the debacle of the Merchants Bank of Canada provoked, and not without reason, a clamor for "reforms" of various sorts including the guarantee of bank deposits. Public opinion was roused by the decline in the number of chartered banks and some were inclined to feel that Canada was or would soon be in the deadly grip of a banking "monopoly." The point is that economic conditions in 1923 were far from satisfactory, and this could not but react on the attitude of the Canadians toward the revision and the remedies considered necessary.[37]

Policies of Bankers' Association. The attitude of The Canadian Bankers' Association toward the revision was wholly negative. No constructive suggestions were made, as regards any of the more important problems such as a more efficient system of audits or rural-credits legislation. The Association contented itself with the issuance of pamphlets calculated to instill "sound" ideas of money, credit and banking in the minds of the populace and to perpetuate the existing law. In their annual reports issued before discussions began in Parliament the banks stressed the contribution of the banking system to the economic life and development of Canada and the importance of maintaining the present act intact. Such changes as were advocated were mere technical alterations.[38]

The Government. The policy of the Government as outlined by the Honorable Mr. Fielding, the Minister of Finance, at the second reading of the bill was that of steering a safe middle course

[37] See article by Mr. Robert P. Webber, in *The Monetary Times*, Vol. 69, p. 6.

[38] See for example the annual report of the Dominion Bank, 1922, p. 25; of the Union Bank, 58th Annual General Meeting of Shareholders, p. 5; and of the Bank of Toronto, 1922, pp. 10–11.

between the Scylla of "do-nothingness" and the Charybdis of "radicalism."[39] The Minister indicated that the Government was decidedly in opposition to government inspection, that it would require an army of officials, would be a costly burden and would be no better than the present system. He said, however, that the present system of audit would be improved and strengthened. Bank mergers were not popular, he admitted, but the suggestion that they be allowed only by act of Parliament was not practicable. Neither was the guarantee of bank deposits feasible. He suggested that loans made under section 88 should be registered to give other creditors better protection. The pension funds of the employees, he announced, were to be given greater protection, records of directors' attendance were to be kept, and greater safeguards were to be thrown about loans to bank officials.

After the bill had been read a second time, it was referred to the Select Standing Committee on Banking and Commerce of the House of Commons, which was given leave to sit while the House was in session, was empowered to send for persons, papers and records and was authorized "to investigate the basis, the function and the control of financial credit, and the relation of credit to the industrial problems" — as well as the revision of the act itself. The problems associated with Rural Credits were to be left to a Select Special Committee of the House whose duty it would be to inquire into Agricultural Conditions. The Banking Committee began its examination of witnesses on April 11 and concluded on May 28, 1923. The testimony taken and the Committee's proceedings occupy 1060 pages. The members of the Committee discussed the revised Bank Act among themselves until the 13th of June and on the 18th the House of Commons resolved itself into a Committee of the Whole to consider the measure which was passed two days later. The more important changes incorporated in the Act dealt with:

(a) the employees' pension funds (Section 18)
(b) attendance of directors (Section 28)
(c) returns rendered by the chartered banks (Section 54)
(d) information sent by bank and its auditors to the Minister of Finance (Section 56A)

[39] *House of Commons Debates,* March 20, 1923, pp. 1310–1314.

(e) shareholders' audits (Section 56)
(f) insurance business (Section 76)
(g) the registration of loans made under Section 88 (Sections 88 and 88A)
(h) over-due debts (Section 113)
(i) controlled companies (Section 113)

The suggested changes which were not adopted treated principally of:

(a) the bank note redemption fund
(b) limitation of loans
(c) contingent reserves
(d) the guarantee of bank deposits
(e) proposals for additional credit institutions

Employees Pension Fund. It was provided (Section 18, Clause 3) that the pension funds of the employees and officers of the chartered banks must be invested in such securities as were eligible for investment by trustees under the Trust Companies Act of 1914. That this was necessary to safeguard the employees was tragically revealed in the case of the Merchants Bank which had invested such funds in its own stock at 160 and on which 110 was realized by the terms of sale to the Bank of Montreal, a loss of 28 per cent.[40]

Attendance of Directors. It was provided that a record of the attendance of the directors was to be sent each shareholder along with the notice of the annual meeting. Though in case a director was unable to attend by reason of residing at a place remote from the head office the nature and extent of his services might be explained. As indicated by Mr. Fielding there had been considerable complaint that the directors in some instances were mere figureheads and it had been alleged in connection with the Merchants Bank that they had given lax attendance and paid little attention to the affairs of the bank. This provision was an effort to correct the situation.[41] Of course, Mr. Fielding was not

[40] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 4.

[41] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, pp. 855 and 937.

overly optimistic regarding the results to be derived but looked upon this requirement as a concession to public opinion which held that the non-attendance or lax attendance of the directors and their lack of interest in the affairs of the bank might account in part for the bank failures in Canada.[42]

The Returns. Various amendments to Section 54 were adopted which tended not only to make the returns clearer and reveal additional information, but also to compel banks to disclose their true monthly condition. Thus any losses which occurred must be embodied in the statements monthly instead of at the time of the issuance of the annual statement and appropriations must be set aside monthly for such contingencies.[43] The additional information required were the amount of advances under the Finance Act, the total liability of banks under letters of credit, the amount of United States and other foreign currencies held, and the substitution of the expression, " non-current loans " for " over-due debts." In addition it was required that the statements of controlled companies be published annually which is in accord with the practice of English banks.

Shareholders' Audits. Some of the most thoroughgoing changes were made in Section 56 strengthening the provisions providing for an audit by representatives of the shareholders which we shall discuss later.[44]

Information to Minister of Finance. By Section 56A it was provided that the auditors' reports should be sent the Minister of Finance. Under the old Act the Minister could order a special audit of a bank, yet such action would cause public alarm and be tantamount to the admission of insolvency. But under the Act as amended the auditors' reports are filed in routine-like fashion and a close and constant check maintained over the bank.[45]

Insurance Business. The Canadian Federation of Insurance Agents severely criticized the banks on the score that they influenced the placing of the insurance of their borrowers, forcing

[42] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 1038. See also pp. 704–705 and 701.

[43] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1924, p. 28.

[44] See pp. 436–441.

[45] See *Proceedings of the Select Standing Committee on Banking and Commerce*, 1924, p. 23.

them to place this with affiliated Trust Companies, a practice which they declared was contrary to the intent of the act. The bankers denied that any such compulsion had been exerted. But to make a rather long controversy short, a provision was inserted prohibiting an agent or manager of a bank from acting as the agent for an insurance company or from exercising pressure upon any borrower to place insurance in any particular agency.

Over-Due Debts. Some confusion had existed as regards the exact meaning of the term over-due debts as appearing in the 1913 act which the Minister of Finance desired to eliminate through a precise definition. In the original draft of the revised bill the Hon. Mr. Fielding had inserted a section to the effect that this was to be defined as one on which no interest had been paid for a period of twelve months. But the banks felt this to be unduly severe for, as Sir Frederick Williams-Taylor indicated, it would cover 50% and upwards of farm loans in certain sections of the Prairie Provinces. The banks had been sustaining and assisting the farmers, suffering from the deflation of agricultural prices, and though such loans were good ultimately, they would have to be classed as bad. Also, he declared, interest was in arrears on some lumber loans owing to the then existing market conditions.[46] Mr. Clarkson felt that such a definition would be exceedingly harmful to the farmers and stock-raisers of the Northwest Provinces: —[47]

"If the proposed definition shall be put in force, a large portion of such loans will require to be shown in the banks' statements as 'over-due debts' and, with this the case, the banks will be compelled to take action to make their customers pay the interest upon their loans even to the extent of forcing them to realize their assets and at a sacrifice. The banks will also be debarred in many instances from making future advances for fear that they in turn will become 'over-due debts' before they would be repaid."

In the final revision the Minister considerably modified his definition so that the section as amended reads: [48]

[46] *Proceedings of Select Standing Committee on Banking and Commerce*, 1923, p. 285. See also p. 630.

[47] *Ibid.*, p. 711.

[48] 13–14, George V., Chap. 32, Section 113, Par. 5.

For the purposes of any return provided for or required under the last preceding section, or for the purposes of any statement or balance sheet prepared and issued by a bank, there shall not be included amongst "current loans," any loan in respect of which, —

(a) the borrower has not for a period of two years preceding the date of such return, statement or balance sheet, paid the interest thereon at the rate agreed, in cash, unassisted by the bank;
(b) the bank has taken possession of the property or any part of the property covered by any security given by the borrower with the intention of realizing thereon, or has realized or taken any step or proceeding for the purpose of realizing upon any security given by the borrower;
(c) the bank has commenced an action at law to recover from the borrower the amount of the loan or any part thereof;
(d) the borrower has made an abandonment of his estate for the benefit of his creditors or any of them; or,
(e) there is other cause, sufficient in the opinion of the manager of the branch of the bank where such loan is domiciled, or in the opinion of any director or officer of the bank who prepares, signs, approves or concurs in such return, statement or balance sheet, for deeming such loans not to be a current loan.

Provided, however, that any loan falling within this subsection may be included amongst current loans if the directors declare that after due inquiry they have approved such loan as a current loan.

From the point of view of the American student the significant feature of the testimony given in opposition to the Minister's original proposals was the statements made in regard to the assistance rendered by the chartered banks to their agrarian clients. They were in a pathetically depressed condition, arising from economic forces beyond their control and as the statements revealed were carried along by the banks, able to withstand this burden of frozen loans by reason of their tremendous and diversified resources. The small local banks in the United States

were not only unable to do this, but actually failed by the hundreds and thousands.

Numerous other amendments were adopted respecting loans made under the terms of Section 88, the returns of controlled companies and loans to officers and directors which are discussed elsewhere. The penalty provisions were recast to give greater protection to depositors and shareholders.

Rejected Proposals. A considerable amount of time was devoted to a number of proposals which were ultimately rejected. The guarantee of bank deposits received as much attention as any of the defeated issues proposed. The champion of this was a Mr. Ladner, who advocated the guaranteeing of all savings accounts up to and including $3,000. This was necessary, he claimed, if confidence were to be restored in Canadian banks, if the smaller banks were to be placed on a competitive footing with the larger and if the savings of the Dominion were to be diverted from long-term investments to the chartered banks.[49] Mr. Ladner indicated that deposits in the Postal Savings Bank, a Dominion creation, were guaranteed, as were deposits in the Provincial savings banks of Ontario. Regarding the method to be followed, he suggested that a lower rate of interest be paid on the guaranteed deposits which would then be used to accumulate a fund from which the deposits of the failed banks could be paid. The chartered banks and the financial press were without exception opposed. In a pamphlet issued by the Bankers' Association the statement is made that such laws are "unmoral, fundamentally unsound, inherently unjust, and fraught with danger to banking stability."

During the Bank Act discussions, several proposals were put forth for the establishment of additional credit institutions. Some favored the establishment of Provincial banks, similar in functions and powers to the chartered banks but owned by the Provinces, and tied up with the rediscount powers of the Treasury. Others claimed Canada needed a Federal Reserve System, a Bank of Canada,[50] or an institution similar to the Commonwealth Bank of Australia. Among the arguments advanced were that additional credit would become available, and that a more equitable distribution would be brought about, that interest rates would be-

[49] See *House of Commons Debates,* April 9, 1924, pp. 1185–1187.
[50] *House of Commons Debates,* July 2, 1924, p. 3917.

come lower and more uniform and that rediscount facilities were needed to take care of the seasonal and cyclic credit needs of the chartered banks.[51] As regards proposals for a Federal Reserve System, Professor Swanson's testimony is pertinent and to the point: [52]

" With respect to this system a good deal is said to the effect that it would reduce the rate of interest. Instead of reducing the rate of interest its chief danger would be the inflation of credit. The rate of interest would be controlled more or less as it is in the United States; but there is a very grave danger, in my opinion, in giving that power to a body of men. I don't think it is required in Canada. Our banks have the resources right now. It is not the case that we have not the money. No Federal reserve scheme superimposed on our banks could increase the credit to a much greater degree than the banks can increase their credit right now. When a bank says it is not able to extend its loan in an individual case, often it is because the security or the character of the borrower, either one or the other, is not up to par."

Lastly and finally, another proposal which was defeated was the suggestion that the charters of the banks be extended for only a year, during which time a thorough and comprehensive revision could be undertaken. This was sponsored principally by members of the Progressive Party, as well as by numerous farmers' organizations and by the Governments of Alberta and Manitoba. The points were made that the bill had been rushed through the Committee and the House, that the proceedings of the Agricultural Committee should be awaited and studied, that the curtain should be raised on the Merchants Bank debacle and credit conditions in Western Canada, that the advisability of a national currency should be considered, etc. The leaders of the two large parties were opposed and these proposals were defeated.[53]

[51] As regards the proposals for the Provincial banks see Professor McGibbons' report, pp. 37–42.

[52] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 784. See also pp. 301, 363, and 297–298.

[53] See *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, pp. 825, 857, 882, 885, and *House of Commons Debates*, 1923, pp. 4034, 4035, 4037, 4040, 4048, and 4160.

RESULTS OF REVISION. The 1923 Act embodied no far-reaching changes, no revolutionary changes in the credit and financial organization of Canada. The new provisions were all in the direction of greater supervision and publicity, in the direction of conservatism. From their point of view, the chartered banks were pleased that the " radical " proposals of the critics of the banking system had been defeated and, particularly, that government inspection was sidetracked.

AMENDMENT OF 1924. As a consequence of the failure of the Home Bank, whose liabilities were larger than those of any bank which had failed since 1868, provision was made for the Government inspection of the chartered banks in an amendment assented to on July 19, 1924. The work of bank examination was to be placed in the hands of an official known as the Inspector General of Banks.[54] It was for the inclusion of such an amendment that Mr. McLeod had devoted himself so generously and wholeheartedly and which was achieved finally as a result of this disastrous failure.

SUMMARY. In the development or evolution of the Canadian Bank Act the tendency has unmistakably been towards a greater degree of government control and supervision. The earlier revisions dealt chiefly with the note issue provisions until, in 1891, not only the ultimate but also the immediate redemption of the notes of failed banks was a *fait accompli*. As a further agency of control (analogous to the mutual type of supervision exercised by clearing houses in the United States), The Canadian Bankers' Association was incorporated in 1900 and given supervision over the printing of the bank notes and insolvent banks. The shareholders' audit was first provided in 1913, strengthened in 1923, and supplemented by external inspection or examination in 1924. The increasing inelasticity of the bank note (which will be discussed at a later point), due to the failure of bank capital to increase, led to the amendment of 1908 providing for the emergency circulation. As an illustration of the tendency to subject the chartered banks to a larger amount of publicity may be cited the requirements respecting more detailed returns until, in 1923, the provision was inserted requiring the returns of subsidiary concerns. The increasing severity of directors' qualifications and liabilities is another case in point. The quasi-public

[54] For a fuller treatment, see pp. 441–444.

nature of banking, the desirability of strict control and oversight, the trustee relationship of banker to depositor, have been given marked emphasis.

OTHER TYPES OF CREDIT INSTITUTIONS. Before proceeding to a more detailed treatment of the operation and administration of the chartered banks and their rôle in the economic organization of Canada, brief mention will be made of the other types of credit institutions. Fiduciary functions are handled entirely by trust companies. Unlike banks in the United States, which are departmentalized or heterogenous institutions handling all types of business (somewhat after the fashion of German banks), the fiduciary functions in Canada are handled entirely by the trust companies. These operate under either Dominion or Provincial charter [55] with the larger companies organized under the latter. While the chartered banks do not undertake this work, some do have rather close relations or are affiliated through interlocking boards of directors with the trust companies. The following table gives the assets and liabilities of trust companies in 1923: [56]

Items	Provincial Companies	Dominion Companies	Total
	$	$	$
Assets —			
Company Funds	32,172,116	10,830,509	43,002,625
Guaranteed Funds	40,436,259	10,649,004	51,085,263
Estates, Trusts and Agency Funds	648,253,964	102,764,835	751,018,799
Total	720,862,339	124,244,348	845,106,687
Capital Stock —			
Authorized	32,800,000	16,100,000	48,900,000
Subscribed	19,602,700	9,653,750	29,256,450
Paid up	16,731,329	7,772,749	24,504,078
Reserve and Contingency Funds	9,871,011	1,908,887	11,779,898
Unappropriated Surplus	1,133,549	104,699	1,238,248
Net profit realized during year	1,753,281	348,474	2,101,755

[55] Two of the largest, the Montreal Trust Company and the Royal Trust Company, operate under the laws of Quebec. The former, which is reputed to be closely affiliated with the Royal Bank, had as of a recent date gross total liabilities of 135 millions of dollars while the latter, reputed to be closely affiliated with the Bank of Montreal, had gross total liabilities of 358 millions of dollars. The National Trust Company, an Ontario institution, had gross total liabilities of 139 millions of dollars.

[56] *The Canada Year Book*, 1925, p. 846.

Rural Credits. Except for Prince Edward Island, all the Provinces have enacted legislation providing for long-term loans to settlers and farmers. The land banks or farm loan boards established have in the main been on a small scale and able to render but little assistance. The small size of each precludes the possibility of the marketing of a large volume of bonds. As later indicated, a needed reform in Canadian financial organization is a Dominion land bank or at least some unification between the provincial banks. A plan having this for its object was introduced in the House of Commons at the Fourth Session of the Fourteenth Parliament (Bill 237) but failed to pass. Despite the fact that the total loans of the Provincial land banks or farm boards, as Dr. Tory has indicated, amounts to only $23,000,000, or to about 10% of the total farm mortgage indebtedness of Canada, their existence has been justified in educating the public to the value and cheapness of the amortization principle. Their effect on interest rates has been negligible.[57] The Canadian farmer procures his mortgage funds as did his brother agriculturist in the United States prior to the passage of the Federal Farm Loan Act, from life insurance trust and loan companies, and private individuals.[58]

Loan Companies. These are quite similar in their functions to Building and Loan Associations in the United States with the exception that some lend not only on city, but also on rural mortgages. In 1924 a total of 127 such companies were in existence, incorporated under Dominion and Provincial law. Statistics of these companies as of 1923 are shown in the table at the top of the next page.[59]

Savings Banks. There are two systems of savings banks under Dominion management. There are, first, the Post Office Savings Banks, established under the Act of 1867, and second, the banks attached to the Department of Finance under the management of the Assistant Receiver-General. Both of these have been losing deposits within recent years due to the keen competition of

[57] For a detailed discussion of rural credit legislation in Canada, see *Report on Agricultural Credit,* by H. M. Tory, printed by Order of Parliament, 1924, and *Agricultural Loans,* a pamphlet issued by the Dept. of the Interior, Ottawa.

[58] See James B. Morman, *Farm Credits in the United States and Canada,* Chap. XIII, and address of V. Evan Gray, published in *Loan and Trust Corporations' Statements,* Toronto, 1922, pp. 224-243.

[59] *The Canada Year Book,* 1925, pp. 845-846.

Items	Provincial Companies	Dominion Companies	Total
	$	$	$
Book value of Assets	83,319,970	104,866,102	188,186,072
Liabilities to the public	42,175,344	63,600,094	105,775,438
Capital Stock —			
Authorized	55,955,860	94,178,780	150,134,640
Subscribed	22,939,232	36,503,340	59,442,572
Paid up	22,473,552	24,939,622	47,413,174
Reserve and Contingency Funds	16,098,586	14,879,516	30,978,102
Other liabilities to shareholders	1,749,768	1,420,574	3,170,342
Total liabilities to shareholders	40,321,906	41,239,712	81,561,618
Net profit realized during year	2,018,549	2,125,393	4,143,942

the chartered banks and trust companies. The postal savings deposits reached in 1908 a maximum of nearly 48 million dollars. Since then there has been a 50% decline. The Dominion Government Savings Banks have shown even a greater decline. In 1887 their deposits amounted to 21 million dollars while now they are slightly under 9 millions.[60] In addition to these there are several other governmental savings banks. In Montreal there is the City and District Savings Bank, founded in 1846 and in Quebec, the Caisse d'Economie de Notre Dame, founded in 1848. Ontario has a system of Government savings offices established as sub-treasury offices. These, of which there are 15, are located principally in the western parts of the Province. A somewhat similar system is in operation in Manitoba, where four of five sub-treasury offices of the Province accept deposits. Alberta encourages thrift and incidently borrows through the sale of Savings Certificates which draw 4½% per annum.[61]

Coöperative Banks. Coöperative credit societies have reached a high stage of development in Quebec, where there were, in 1923, 113 with an annual business of $11,000,000.[62] In fact this Province is the birthplace of the coöperative credit movement in America and its societies served as a model for the first credit

[60] Annual statistics of these may be found in *The Canada Year Book*.
[61] The Provincial savings offices were organized largely as a means of securing cheap credit for Provincial Government purposes. They have not been overly successful.
[62] *The Canada Year Book*, 1925, pp. 710–712.

union law enacted in the United States, in Massachusetts in 1909. There are a few such societies in Ontario.

Bond Houses.[63] The following table presents a list of the nine leading investment houses of Canada, the date of their establishment and the laws under which they are at present incorporated. The first three on the list are the largest and the best established institutions in the Dominion in this business.

CANADA'S LEADING INVESTMENT HOUSES

	Charter	Business Established
A. E. Ames & Co., Ltd., Toronto	Dominion	1889
Dominion Securities Corp. Ltd., Toronto	"	1901
Wood, Gundy & Co., Ltd., Toronto	"	1905
Greenshields & Co., Montreal	"	1910
Royal Securities Corp. Ltd., Montreal	"	1903
McLeod, Young, Weir & Co., Ltd., Toronto	"	1921
R. A. Daly & Co., Toronto	"	1916
Nesbitt Thomson & Co., Ltd., Montreal	"	1912
Hanson Bros., Montreal	"	1883

There are approximately 218 bond houses, but the above nine are the outstanding ones. They are the firms which originate the new issues and carry on a wholesale business in Canada's growing bond investments. The only connection between these institutions and the chartered banks is that frequently they may purchase an issue from a corporation and then obtain funds from one of the banks to carry this until it has been marketed, which is usually a period of short duration. Of course, the chartered banks themselves sell bonds, but usually those issued by the Dominion, the Provinces or some political sub-division or by a railroad. They do not have subsidiary investment houses such as typified by the National City Company or the Chase Securities Corporation in New York City.

This concludes our preliminary survey, necessarily very brief, of the whole of Canada's financial organization. The next section will be devoted to a more detailed analysis of the present Bank Act and of the operations of the chartered banks.

[63] For the information contained in this section the author is indebted to Mr. H. M. Cameron. In addition to concerns strictly Canadian, the National City Company and Harris Forbes are quite active in Canada.

THE COMMERCIAL BANKING STRUCTURE

THE BANK ACT. The legal basis for the commercial banking structure in Canada is to be found in Section 91 of the British North America Act of 1867, which conferred exclusive authority in the matter of incorporating and regulating banks of issue on the Dominion Parliament. In pursuance of these powers the first Bank Act was passed in 1871 which prescribed the manner of incorporation and general powers of the chartered banks and granted them charters of ten years' duration. As mentioned before, this grant of life has led to the decennial revisions of the Bank Act, which have taken place in 1881, 1891, 1901, and 1913. The latest revision was assented to on June 30, 1923 and amended in some important particulars on July 19, 1924.[64] This Act consists of 160 sections or clauses which may be divided into the following classifications:

A. Interpretation and application	Sections 1– 7
B. Incorporation of new banks	8–17
C. Internal regulation as regards:	18–60
Capital stock	
Shares and calls	
Transfer and transmission of shares of stock	
Shares subject to trusts	
Annual and special statements	
Audits	
Government inspection	
Dividends and reserves	
D. Note issues	61– 74
E. Business and powers of the banks	75– 98
F. Purchase of another bank's assets	99–111
G. Returns to the Government	112–114
H. Insolvencies, Liquidations, etc.	115–131
I. Offenses and Penalties	131–163

This statute including the 1924 amendment is a lengthy document of some 90 pages, which makes it a close rival in size to the Na-

[64] For an account of the development of the Bank Act, see pp. 298–317.

tional Bank Act of the United States, and as a matter of passing interest, it is the most complete and detailed general banking law existing in any part of the British Empire.

Incorporation of a Bank. While the Bank Act specifies in considerable minutiæ the procedure to be followed in the establishment of a bank, and lays down rather detailed rules governing its powers and rights, the charter itself can be conferred only upon the passage of a special act by Parliament. Hence the term chartered bank. The special act of incorporation is introduced as a private bill, is subject to three readings in both the House of Commons and the Senate, and must receive the approval or assent of the Governor-General. The bill must give:

(a) The name of the proposed bank;

(b) The names of the incorporators, who in the ordinary course would become the provisional directors and who must not number less than five;

(c) The proposed capital, which must not be less than $500,000, to be divided into shares of $100 each, which bear double liability;

(d) The location of the head office.

After its second reading, the bill is referred to the banking committee in each chamber, upon whose report its fate generally depends.

The method of bank incorporation in Canada is strikingly different from the procedure followed in the majority of the United States where, aside from such exceptions as the Federal Reserve Banks, the Federal Land Banks, and the Bank of North Dakota, banks receive their charters not by special legislation, but, after complying with a general banking law, from the state superintendent or commissioner of banks or from the Comptroller of the Currency in Washington, in the case of the National Banks. Delaware is one exception to this general rule, as state banks there are still incorporated by special act. Generally speaking, however, banks are incorporated under a general law and receive their charters from the official to whom its administration has been delegated. This official in the case of the Federal Govern-

ment and most states makes a more or less careful examination into the need for a new bank, the character of management, and the prospects of success if well managed. In a few states, however, the banking commissioner is given no discretionary power and cannot legally refuse a charter if the incorporators have complied with the law, no matter what the success of the bank may likely be or the character of the organizers. The lack of such discretionary power as well as the lax methods of bank administration and supervision in certain states, even where the Superintendent is permitted to exercise his judgment, have been among the factors responsible for the establishment, during the war and post-war inflation period, of thousands of crossroads and fly-by-night concerns, with a consequent overbanked condition in some parts of the nation. Thus North Dakota in 1920 had one state bank for every 916 persons, Kansas one for every 1598, Nebraska one for every 1290, South Dakota one for every 1142, Iowa one for every 1786, as compared with New York, for example, where there was one bank for every 31,000 persons, California one for every 8,287 and New Hampshire one for every 31,648 persons.[65] Even allowing for the lessened density of population in the Middle Western states, there is no doubt but that these sections were overbanked, and that this condition in part resulted from the lax supervision over bank incorporation. And it is precisely there that the bank failure epidemic has raged the past six years. The mushroom banks could not withstand the depression. One of the lessons learned is the need for a more rigid supervision over bank incorporation. This would not mean the adoption of the Canadian requirement of a special act of incorporation, but it does mean the granting of discretionary power to state bank commissioners to refuse charters, as well as the raising of standards for new banks, and the elimination of political influence. In some states banking supervision has reached a very high level, but in many the subject merits serious study and consideration.

The chartered banks, operating under the Bank Act at the present time, listed in the order of their establishment are:

[65] Pp. 62–63 of *Hearings before a Subcommittee of the Committee on Banking and Currency,* United States Senate, Sixty-Ninth Congress, First Session, on S. 1782 and H. R. 2. Washington: Government Printing Office, 1926.

Name of Bank	Location of Head Office	Date Established
Bank of Montreal	Montreal, Que.	1817
Bank of Nova Scotia	Halifax, N. S.	1832
Bank of Toronto	Toronto, Ont.	1855
Banque Provinciale du Canada (successor of Banque Jacques Cartier)	Montreal, Que.	1861
Canadian Bank of Commerce	Toronto, Ont.	1867
Royal Bank of Canada (successor of Merchants Bank of Halifax)	Montreal, Que.	1869
Dominion Bank	Toronto, Ont.	1871
Banque Canadienne Nationale (formerly Banque d'Hochelaga)	Montreal, Que.	1874
Imperial Bank of Canada	Toronto, Ont.	1875
Weyburn Security Bank	Weyburn, Sask.	1911

As will be observed, the head office of each of these banks [66] is located either in Toronto or Montreal with the exception of the Bank of Nova Scotia and the Weyburn Security Bank. In the case of the former, the general manager's office is in Toronto, where it was moved in 1900 to bring about a closer telegraphic contact with the New York and Chicago money markets and with the rest of Canada. The head office is still retained in Halifax as a concession to local pride. The Weyburn Security Bank with its head office in Weyburn, Sask., is a comparatively small concern operating in one province and serving a more or less restricted clientele. With this one exception, then, two cities house the main operating offices of all the chartered banks. To those interested in banking technique, it may be noted in passing that the head office of a Canadian bank does not itself engage in receiving deposits or in making loans. Even the banking office, if such exists, in the building in which the head office is located is considered as a branch. The head office, in short, formulates policies, establishes branches, passes on loans of over a certain size, makes investments, makes plans for new and altered buildings and their equipment, purchases stationery for branches,

66 Rather elaborate historical accounts of their own development have been prepared by the Canadian Bank of Commerce, the Bank of Montreal, the Bank of Nova Scotia, and the Dominion Bank. In passing it might be noted that the original charters of the Bank of Nova Scotia and the Bank of Montreal were quite similar to the charters of the first and second Banks of the United States, and that these were themselves based on recommendations of Alexander Hamilton.

designs new forms, transfers and promotes employees, acts as a center for the purchase and sale of foreign exchange, etc. It is the nerve center of each banking organization, which might include as many as 900 branches at home and abroad, as in the case of the Royal Bank.

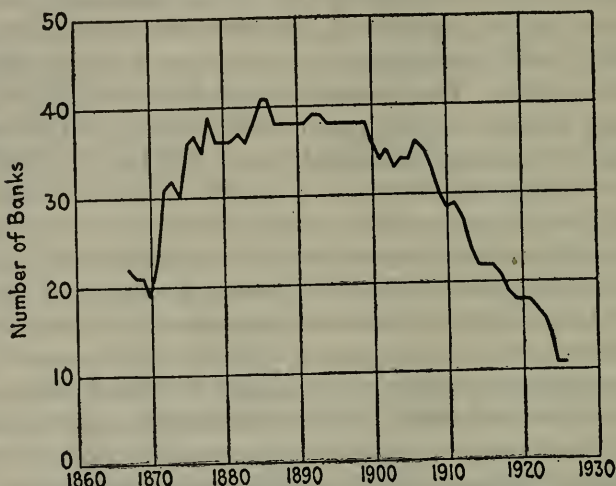
Tendency Toward Fewer and Larger Banks. The eleven chartered banks now serving the commercial credit needs of Canadian business, agriculture, and commerce represent the survival of a much larger number of institutions formerly operating in the Dominion. The tendency toward fewer and larger banks has been perhaps the outstanding characteristic of the banking structure of Canada within recent years. Not that the disappearance of banking institutions is a condition peculiar to the Dominion, for the same condition has manifested itself also in other countries. So aroused, indeed, did public opinion become in England over this problem, that a Treasury Committee [67] was appointed to investigate whether amalgamations were prejudicial to the interests of the industrial and mercantile community and whether legislation might not be needed to cope with the issue.

Nor must it be thought that the amalgamation movement has been confined solely to branch banking countries such as Canada and England, in fact, in the United States, a country with a unit independent type of banking system, the number of bank mergers and consolidations beginning in 1918 increased rapidly. This movement embraced all types of banks, national and state banks, trust companies, savings banks and private banks.[68] In discussing, then, the Canadian experience it is important to bear in mind that the tendency to fewer banks is world-wide and *is not a phenomenon whose appearance is due to the type of banking system existing there.* The same trend, with differences in degree of course, has been experienced in other countries and with other types of banking organization.

[67] *Report of the Treasury Committee on Bank Amalgamations.* London: published by His Majesty's Stationery Office, 1918. For a thorough study of this problem, see *The Amalgamation Movement in English Banking, 1825–1914,* by Joseph Sykes, published by P. S. King & Son, Ltd., London, 1926.

[68] See p. 106 of *Hearings before a Subcommittee of the Committee on Banking and Currency,* United States Senate, 69th Congress, 1st Session, on S. 1782 and H. R. 2.

Statistics of Bank Disappearance. Turning now to the statistics of bank disappearance in Canada, as shown in the accompanying chart, the number of banks reporting to the Government reached a maximum of 41 in the years 1885 and 1886. In 1900 there were still 36 in existence, while by 1915, there were but 22 and at the present time but 10. From 1900 to date there has been



Number of Chartered Banks Reporting to the Canadian Government as of December 31st of Each Year.

a decline of 73%, and since 1915, 55%. Of the banks disappearing since 1915, six lost their identity through the years 1923, 1924 and 1925.[69]

Additional and more detailed statistical evidence of bank disappearance in Canada is given in the following table which presents the number of amalgamations, failures and voluntary liquidations yearly since 1900, and it should be remembered that these were the years of Canada's greatest economic growth:

[69] Source of data: R. M. Breckenridge, *The History of Banking in Canada,* issued under the auspices of the National Monetary Commission, Appendix IV, pp. 287–288, and Returns of the Chartered Banks. For a discussion of the bank mergers through these years, see Appendix D, "Branch Banking Abroad," of Bank Inquiry, 1925, filed by Dr. H. Parker Willis with the United States Senate Committee on Banking and Currency in February of 1926.

STATISTICS OF BANK DISAPPEARANCE

Years	Number of Banks Reporting to Government as of Dec. 31	Number of Amalgamations	Number of Failures	Number of Voluntary Liquidations
1868	21	2	1	
1870	19	1		
1875	36	1		
1883	36	1	1	
1900	36	1		
1901	34	1		
1902	35	1		
1903	33	3		
1904	34	1		
1905	34	1	1	
1906	36	1		1
1907	35	1		
1908	33	2	2	1
1909	30	1		
1910	28	1	2	
1911	29	1		
1912	27	2		
1913	24	2		
1914	22	1	1	
1915	22	0		
1916	22	0		
1917	21	1		
1918	19	2		
1919	18	1		
1920	18	0		
1921	18	0		
1922	17	1		
1923	16	0	1	
1924	14	2		
1925	11	3		
1926	11	0		
1927	11	0		
1928	10	1		

Concentration of Banking Funds. The precipitous decline in the number of banks in Canada has led to an intense concentration of banking funds, to an inequality in the size of banks not characteristic of the banking system of the 90's. This fact is brought out in the table shown on page 330–33 which lists the

chartered banks in existence in 1895, and since then by five-year periods, giving the resources of each and the percentage which these have to the total banking power of Canada.[70] It will be noticed that in 1895 the Bank of Montreal with 17.56% of the whole had the relatively largest resources of any chartered bank. The Canadian Bank of Commerce followed with 9.04 per cent. On July 30, 1927 the Bank of Montreal had 25.98% of the resources of all banks, the Royal Bank 26.09%, the Canadian Bank of Commerce 16.54%. These three banks had 68.61% of the commercial banking resources of Canada. And, if we add the Bank of Nova Scotia, four banks had 77% of the total banking resources, leaving the other seven banks with but 23%. The bank which has shown the greatest *relative* growth in the period from 1895–1926 has been the Royal, with Nova Scotia second, Commerce third, and Montreal fourth.

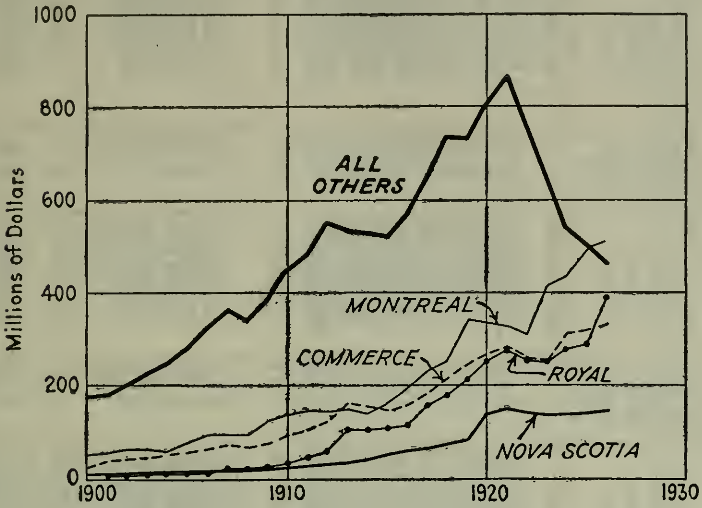
The disappearance of banks, through merger and failure, has had as a significant by-product, then, the creation of institutions of disproportionate power and competitive strength. Not alone has this resulted from the large number of consolidations entered into by the "big four," but there was temporarily at least an actual transference of deposits to the larger banks or alternative institutions growing out of an irrational but nevertheless widespread fear of the instability of the smaller banks, following the failure of the Home Bank.[71] This concentration of power is illustrated by the chart shown on the opposite page which compares the trend in the deposits of the four largest banks with the deposits of the others.[72]

[70] It might be noted that such a condition leads inevitably into a kind of Government guarantee of banking. The Canadian Government could not allow any of the larger banks to fail, for such would be most disastrous to the entire economic structure of the country. The Government would have to lend support if such an institution were approaching insolvency, as indeed it was called upon to do on one occasion before the war.

[71] See p. 55 of *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924. There has also been a transference of deposits to trust companies and the Provincial savings banks. This was but a temporary phenomenon following the Home Bank failure. Comparative data for 1927 and 1923 show that the small banks, so called, have increased their deposits relatively more than the large banks.

[72] Source of data: Returns of the Chartered Banks. The data are as of January 31 of each year excepting in the case of 1926, when they are as of August 31. The deposits include deposits by the public, payable on demand

Reasons for Fewer and Larger Banks. Failures and mergers have accounted for all but a few of the banks losing their identity. This is clearly shown in the table on pp. 334–7, prepared



Fluctuations in the Deposits of the Four Leading Chartered Banks Compared with the Deposits of the Others

by Mr. H. C. McLeod, which gives the names of the banks disappearing, the reasons for their disappearance, and the number of years of independent existence: [73]

in Canada, and deposits by the public payable after notice or on a fixed day in Canada.

[73] This table was prepared by Mr. McLeod shortly before his death and contains much information which he alone possessed.

Date →		July 31, 1895		July 31, 1900		July 31, 1905		July 31, 1910	
Number of Bank	Name of Bank	Total Resources of each Bank	Percent of Resources of All Banks %	Total Resources of each Bank	Percent of Resources of All Banks %	Total Resources of each Bank	Percent of Resources of All Banks %	Total Resources of each Bank	Percent of Resources of All Banks %
1	Bank of Toronto	$15,781,826	5.01	$19,492,277	4.07	$30,310,396	3.96	$ 47,648,751	3.94
2	Canadian Bank of Commerce	28,516,874	9.04	47,545,812	9.93	92,570,895	12.08	151,622,210	12.52
3	Dominion Bank	14,501,721	4.60	21,280,951	4.45	39,646,687	5.17	60,586,656	5.00
4	Ontario Bank	6,931,677	2.20	9,551,030	2.00	15,555,634	2.03	....	.....
5	Standard Bank	7,713,195	2.45	10,385,403	2.17	16,579,120	2.16	32,093,637	2.65
6	Imperial Bank of Canada	14,227,848	4.51	20,278,807	4.24	34,281,236	4.47	59,326,608	4.90
7	Traders Bank of Canada	5,822,051	1.85	9,385,430	1.96	23,090,968	3.01	43,689,007	3.61
8	Bank of Hamilton	8,646,002	2.74	14,967,441	3.13	28,902,257	3.77	39,751,328	3.28
9	Bank of Ottawa	7,970,801	2.53	15,717,078	3.28	23,966,740	3.13	40,277,555	3.33
10	Western Bank of Canada	1,971,645	.63	2,681,780	.56	5,414,375	.71	....	.....
11	Bank of Montreal	55,366,476	17.56	93,158,262	19.46	147,832,814	19.29	233,992,326	19.32
12	Bank of British North America	11,898,398	3.77	40,277,408	8.41	40,840,273	5.33	55,463,740	4.58
13	Banque Jacques Cartier	4,751,869	1.51	....	.....	....	.....	....	.....
14	Banque Ville Marie	1,753,470	.56	....	.....	....	.....	....	.....
15	Banque d'Hochelaga	5,794,776	1.84	9,669,583	2.02	15,162,786	1.98	22,386,126	1.85
16	Molson's Bank	14,694,778	4.66	20,054,327	4.19	30,050,348	3.92	42,269,512	3.49
17	Merchants Bk. of Canada	23,928,378	7.59	29,703,797	6.20	42,349,010	5.53	66,328,590	5.48
18	Quebec Bank	11,119,835	3.53	12,202,080	2.55	13,501,682	1.76	15,556,236	1.28
19	Union Bank of Canada	7,427,829	2.36	10,916,828	2.28	23,265,208	3.04	43,783,494	3.62
20	Banque de St. Jean	388,332	.12	709,770	.15	756,418	.10	....	.....
21	Banque de St. Hyacinthe	1,590,270	.50	1,682,944	.35	1,431,031	.19	....	.....
22	Eastern Townships Bank	6,266,509	1.99	9,394,661	1.96	16,868,550	2.20	23,942,292	1.98
23	Banque du Peuple	8,663,308	2.75	....	.....	....	.....	....	.....
24	Banque Nationale	4,763,532	1.51	6,856,111	1.43	10,676,638	1.39	16,821,508	1.39
25	Bank of Nova Scotia	11,970,948	3.80	20,561,018	4.30	32,380,012	4.23	49,815,007	4.11

26	Merchants Bank of Halifax*	9,275,895	2.94	18,337,248	3.83	....	.....	....	.....
27	Peoples Bank of Halifax	3,036,365	1.00	3,557,764	.74	....	.....	....	.....
28	Union Bank of Halifax	2,778,641	.88	5,596,477	1.17	11,220,969	1.46	15,289,668	1.26
29	Halifax Bkng. Company	3,662,812	1.16	4,939,500	1.03				
30	Bank of Yarmouth	1,043,026	.33	1,015,056	.21	....	.....	....	.....
31	Exchange Bank of Yarmouth	471,627	.15	578,695	.12	....	.....	....	.....
32	Commercial Bk. of Windsor	922,687	.29	1,523,855	.32	....	.....	....	.....
33	Bank of New Brunswick	3,380,944	1.07	3,844,431	.80	5,714,651	.75	10,129,360	.84
34	Peoples Bank of New Brunswick	760,027	.24	913,924	.19	974,594	.13	....	.....
35	St. Stephen's Bank	597,933	.19	698,858	.15	858,045	.11	....	.....
36	Bank of British Columbia	6,310,638	2.00	7,832,209	1.64	....	.....	....	.....
37	Summerside Bank	173,148	.05	271,834	.06	....	.....	....	.....
38	Merchants Bank of Prince Edward Isl.	447,324	.14	972,029	.20	2,014,280	.26	....	.....
39	Banque Provinciale du Can.	....	.....	2,160,257	.45	4,768,608	.62	8,761,394	.72
40	Royal Bank of Canada*	....	.....	....	.....	23,945,814	4.43	75,427,987	6.23
41	Sovereign Bk. of Canada	....	.....	....	.....	12,966,809	1.69	6,209,484	.51
42	Metropolitan Bk. of Canada	....	.....	....	.....	5,556,373	.73	10,300,034	.85
43	Crown Bank of Canada	....	.....	....	.....	2,502,506	.33	....	.....
44	Home Bank of Canada	....	.....	....	.....	362,738	.05	10,051,548	.83
45	Northern Crown Bank of Canada	....	.....	....	.....	....	.....	15,325,738	1.27
46	Sterling Bank of Canada	....	.....	....	.....	....	.....	7,278,760	.60
47	United Empire Bank of Canada	....	.....	....	.....	....	.....	3,702,474	.31
48	Farmers Bank of Canada	....	.....	....	.....	....	.....	2,662,141	.22
49	Bank of Vancouver	....	.....	....	.....	....	.....	361,509	.03
50	Weyburn Security Bank	....	.....	....	.....	....	.....	....	.....
51	Banque Canadienne Nationale	....	.....	....	.....	....	.....	....	.....
	Totals	$315,323,415	100.05	$478,714,935	100.00	$766,318,465	100.01	$1,210,854,680	100.00

Source of data: Returns of the Chartered Banks.

Date →		July 31, 1915		July 31, 1920		July 31, 1925		July 30, 1927	
Number of Bank	Name of Bank	Total Resources of each Bank	Percent of Resources of All Banks %	Total Resources of each Bank	Percent of Resources of All Banks %	Total Resources of each Bank	Percent of Resources of All Banks %	Total Resources of each Bank	Percent of Resources of All Banks %
1	Bank of Toronto	$64,632,250	4.15	$102,543,507	3.32	$102,465,225	3.77	$122,415,365	4.13
2	Canadian Bank of Commerce	230,248,550	14.77	455,938,521	14.75	469,268,542	17.26	489,849,138	16.54
3	Dominion Bank	76,605,397	4.91	140,164,643	4.53	114,430,035	4.21	128,503,643	4.34
4	Ontario Bank	.....	.....	.....	.....	.....	.....	.....	.....
5	Standard Bank	48,534,483	3.11	92,832,114	3.00	82,559,509	3.04	92,649,738	3.13
6	Imperial Bk. of Canada	75,809,567	4.86	130,401,317	4.22	117,101,669	4.31	133,302,821	4.50
7	Traders Bk. of Canada	.....	.....	.....	.....	.....	.....	.....	.....
8	Bank of Hamilton	44,980,715	2.89	86,590,769	2.80	.....	.....	.....	.....
9	Bank of Ottawa	52,051,407	3.34	.....	.....	.....	.....	.....	.....
10	Western Bk. of Canada	.....	.....	.....	.....	.....	.....	.....	.....
11	Bank of Montreal	270,181,285	17.33	562,946,097	18.21	703,378,315	25.88	769,180,668	25.98
12	Bank of British North America	60,867,854	3.90	.....	.....	.....	.....	.....	.....
13	Banque Jacques Cartier	.....	.....	.....	.....	.....	.....	.....	.....
14	Banque Ville Marie	.....	.....	.....	.....	.....	.....	.....	.....
15	Banque d'Hochelaga	32,658,822	2.10	74,601,770	2.41	.....	.....	.....	.....
16	Molson's Bank	51,286,726	3.29	91,096,029	2.95	.....	.....	.....	.....
17	Merchants Bank of Canada	85,030,790	5.45	198,307,602	6.41	.....	.....	.....	.....
18	Quebec Bank	19,987,568	1.28	.....	.....	.....	.....	.....	.....
19	Union Bank of Canada	80,111,853	5.14	164,890,610	5.33	110,752,904	4.07	.....	.....
20	Banque de St. Jean	.....	.....	.....	.....	.....	.....	.....	.....
21	Banque de St. Hyacinthe	.....	.....	.....	.....	.....	.....	.....	.....
22	Eastern Townships Bk.	.....	.....	.....	.....	.....	.....	.....	.....
23	Banque du Peuple	.....	.....	.....	.....	.....	.....	.....	.....
24	Banque Nationale	27,383,197	1.76	69,581,236	2.25	.....	.....	.....	.....
25	Bank of Nova Scotia	98,200,594	6.30	239,490,599	7.75	228,866,096	8.42	248,387,329	8.39
26	Merchants Bank of Halifax*	.....	.....	.....	.....	.....	.....	.....	.....

27	Peoples Bk. of Halifax	...	...	...	...	...	...	...	...
28	Union Bank of Halifax	...	...	...	...	...	...	...	...
29	Halifax Bkng. Company	...	...	...	...	...	...	...	...
30	Bank of Yarmouth	...	...	...	...	...	...	...	...
31	Exchange Bank of Yarmouth	...	...	...	...	...	...	...	...
32	Commercial Bank of Windsor	...	...	...	...	...	...	...	...
33	Bank of New Brunswick	...	...	...	...	...	...	...	...
34	Peoples Bank of New Brunswick	...	...	...	...	...	...	...	...
35	St. Stephen's Bank	...	...	...	...	...	...	...	...
36	Bank of British Columbia	...	...	...	...	...	...	...	...
37	Summerside Bank	...	...	...	...	...	...	...	...
38	Merchants Bank of Prince Edward Isl.	...	...	...	...	...	...	...	...
39	Banque Provinciale du Can.	12,708,850	.82	39,077,524	1.26	41,089,411	1.51	49,841,687	1.68
40	Royal Bk. of Canada*	187,661,665	12.04	587,195,988	18.88	618,738,994	22.76	772,473,639	26.09
41	Sovereign Bank of Canada	...	...	...	...	...	...	...	...
42	Metropolitan Bank of Canada	...	...	...	...	...	...	...	...
43	Crown Bank of Canada	...	...	...	...	...	...	...	...
44	Home Bank of Canada	13,306,404	.85	26,732,456	.86	...	...	...	...
45	Northern Crown Bank of Canada	15,869,521	1.02	...	...	...	...	...	...
46	Sterling Bk. of Canada	9,255,428	.59	25,440,739	.82	...	...	...	...
47	United Empire Bank of Canada	...	...	...	...	...	...	...	...
48	Farmers Bank of Canada	...	...	...	...	...	...	...	...
49	Bank of Vancouver	...	...	...	...	...	...	...	...
50	Weyburn Security Bank	1,497,353	.10	3,842,990	.12	4,835,085	.18	6,453,518	.22
51	Banque Canadienne Nationale	...	...	...	...	124,753,489	4.59	147,994,969	5.00
	Totals	$1,558,870,279	100.00	$3,091,674,511	99.98	$2,718,239,274	100.00	$2,961,052,515	100.00

* Merchants Bank of Halifax was rechartered as the Royal Bank of Canada on Jan. 1, 1901

CANADIAN BANKS PASSING 1817–1926

Opened	Closed	Name	Capital $	Reserve $	Peak of Book Value $	Assets $
1819	1822	Bank of Kingston	$ 48,000	.....	......	......
1818	1831	Bank of Canada	......	.....	......	......
1834	1838	Agricultural Bank	......	.....	......	28,000
1835	1838	Bank of the People (Hincks)	200,000	.....	......	......
1835	1840	Niagara Suspension Br. Bk.	......	.....	......	......
1835	1841	The Farmers Bank	185,000	.....	......	248,000
1855	1857	Zimmerman Bank	300,000	......	......	......
1858	1859	International Bank	......	.....	......	......
1858	1859	Colonial Bank of Canada	......	.....	......	......
1834	1862	Westmorland Bank, N. B.	300,000	.....	......	......
1834	1862	Central Bank of New Brunswick	500,000	.....	......	......
1825	1865	Charlotte County Bank, St. Andrews	60,000	.....	......	......
1821	1866	Bank of Upper Canada	3,266,666	.....	......	7,000,000
1832	1867	Commercial Bank — Midland	4,000,000	.....	......	9,765,000
1835	1868	The Gore Bank	809,280	100,000	909,280	2,741,062
1834	1868	Commercial Bank of New Brunswick	546,400	.....	......	1,222,454
1872	1873	Bank of Acadia	100,000	.....	......	213,346
1855	1875	Niagara District Bank	750,000	.....	......	2,800,000
1871	1875	Metropolitan Bank, Montreal	916,180	.....	......	2,324,053
1873	1875	St. Lawrence Bank, Toronto	692,702	.....	......	......
1874	1876	Stadacona Bank, Quebec	990,890	.....	......	......
1833	1879	City Bank, Montreal	1,482,400	130,000		4,351,768
1860	1879	Royal Canadian Bank, Toronto	2,270,081	.....	......	3,384,154
1876	1879	Consolidated Bank, Montreal				
1865	1879	Mechanics Bank, Montreal	472,245	.....	......	1,500,000
1872	1879	Bank of Liverpool	370,000	.....	......	......
1856	1881	Bank of Prince Edward Island	120,000	45,000	......	1,108,000
1864	1883	Union Bank of P. E. Island	162,222	65,000	227,222	900,000
1872	1883	Exchange Bank of Canada	1,000,000	300,000	......	3,779,493
1872	1887	Maritime Bank of Canada	760,900	60,000	......	1,714,918
1874	1887	Pictou Bank, N. S.	250,000	.....	......	......
1884	1887	Central Bank of Canada	500,000	45,000	......	3,231,518
1884	1887	Bank of London, Canada	241,000	.....	......	1,500,000
1874	1888	Federal Bank of Canada	3,000,000	150,000	......	......
1862	1892	Rustics Bank	8,000	.....	......	......
1885	1893	Commercial Bank of Manitoba	552,650	50,000	......	1,954,167
1835	1895	La Banque du Peuple	1,600,000	600,000	......	9,533,537
1872	1895	Banque Ville Marie	716,920	10,000	......	2,267,516
1861	1899	Banque Jacques Cartier	2,000,000	.....	......	......
1862	1901	Bank of British Columbia	2,920,000	1,338,333	4,258,334	15,661,521
1866	1901	Summerside Bank	48,667	27,193	75,860	292,351
1864	1902	Commercial Bank of Windsor	350,000	60,000	410,000	1,954,167
1825	1903	Halifax Banking Company	600,000	500,000	1,100,000	6,025,479
1869	1903	Exchange Bank of Yarmouth	264,390	.....	......	680,303
1859	1905	Bank of Yarmouth	300,000	35,000	......	820,145

ARRANGED ACCORDING TO YEAR OF CLOSING

Shareholders' Losses			Loss to Shareholders on all counts	Loss to Creditors	Independent Life: Years	Notes
Failed $	Absorbed $	Liquidated $	$	$		
48,000	......	.....	48,000	50,000	3	
.....	......	.....	......	......	13	
Total	......	.....	......	124,000	4	
.....	......	.....	......	......	3	Bought by Bank of Montreal
Total	......	.....	......	......	5	
Total	......	.....	......	......	6	
350,000	......	.....	350,000	88,000	2	
.....	......	.....	......	134,087	1	
.....	......	.....	......	99,878	1	
400,000	......	.....	400,000	......	28	Estimated figures. Creditors paid. Double liability enforced
500,000	......	.....	500,000	......	28	Estimated figures—Creditors paid
60,000	......	.....	60,000	......	40	
3,266,666	......	.....	3,266,666	1,300,000	45	
2,665,000	......	.....	2,665,000	......	35	Merchants Bank bought assets — losing heavily
465,000	......	.....	465,000	......	33	
495,000	......	.....	495,000	......	34	
130,000	......	.....	130,000	......	1	
.....	———	.....	......	......	20	
456,180	......	.....	456,180	......	4	
.....	191,452	.....	191,452	......	2	
.....	......	———	......	......	2	A voluntary liquidation
.....	1,590,451	.....	1,590,451	......	46	The City Bank and the Royal Canadian Bank —both insolvent—were merged into Consolidated Bank
.....	2,002,081	.....	2,002,081	......	19	
569,732	......	.....	569,732	180,000	14	
500,000	......	.....	500,000	......	7	
310,000	......	.....	310,000	......	25	
.....	64,888	.....	64,888	......	18	
1,650,000	......	.....	1,650,000	800,500	11	
1,082,800	......	.....	1,082,800	974,870	15	
.....	......	163,970	163,970	......	13	
.....	......	750,000	750,000	7,100	3	
80,000	......	.....	80,000	......	3	
.....	......	4,469,113	4,469,113	......	14	Total losses $4,517,277. A large sum was recovered from the President
.....	......	.....	......	......	30	Unable to obtain renewal of Charter
700,000	......	.....	700,000	......	8	
1,900,000	......	.....	1,900,000	1,718,284	60	
716,920	......	.....	......	1,341,601	23	
1,750,000	......	.....	......	......	38	Shareholders' interest sold for $250,000 —
.....	1,446,334	.....	1,446,334	......	29	
.....	———	.....	......	......	35	A small bank with a fine record
.....	50,425	.....	50,425	......	38	
.....	44,000	.....	44,000	......	78	
.....	......	.....	......	......	34	Bought by Bank of Montreal
335,000	......	.....	335,000	......	46	

CANADIAN BANKS PASSING 1817-1926

Opened	Closed	Name	Capital $	Reserve $	Peak of Book Value $	Assets $
1864	1905	Peoples Bank of Halifax	1,000,000	440,000	1,440,000	6,394,619
1859	1906	Ontario Bank	3,500,000	700,000	4,200,000	17,432,177
1871	1906	Merchants Bank of P. E. Isl.	350,400	331,000	681,400	2,036,272
1869	1907	Peoples Bank of New Brunswick	180,000	180,000	360,000	1,041,410
1873	1908	Banque de St. Hyacinthe	331,235	75,000	......	1,580,097
1873	1908	Banque de St. Jean	316,386	10,000	......	326,118
1901	1908	Sovereign Bank of Canada	4,000,000	1,250,000	......	19,218,746
1904	1908	Crown Bank, Toronto	957,435	95,750	......	......
1905	1908	Northern Bank, Winnipeg	1,239,961	121,538	......	......
1877	1909	Western Bank	555,000	350,000	905,000	5,949,307
1856	1910	Union Bank of Halifax	1,500,000	1,200,000	2,700,000	25,333,104
1836	1910	St. Stephen's Bank, N. B.	200,000	60,000	......	801,872
1906	1911	United Empire Bank	582,231	.....	......	......
1906	1910	The Farmers Bank	567,579	.....	......	2,616,683
1860	1912	Eastern Townships Bank	3,000,000	2,400,000	5,400,000	27,604,803
1885	1912	Traders Bank	4,480,000	2,552,750	7,032,750	51,245,937
1820	1913	Bank of New Brunswick	1,000,000	1,790,000	2,790,000	11,975,000
1911	1913	Banque Internationale du Canada	1,359,833	.....	......	2,841,415
1902	1914	Metropolitan Bank of Toronto	1,000,000	1,250,000	2,250,000	12,365,216
1910	1914	Bank of Vancouver	445,188	.....	......	1,532,786
1818	1917	Quebec Bank	2,735,000	1,308,675	4,043,675	20,296,375
1835	1918	Bank of British North America	4,866,667	3,017,333	7,884,000	78,251,952
1908	1918	Northern Crown Bank	2,851,718	350,000	3,201,718	27,819,291
1875	1919	Bank of Ottawa	4,000,000	5,000,000	9,000,000	66,451,484
1864	1922	Merchants Bank of Canada	10,500,000	9,450,000	19,950,000	182,004,625
1855	1923	Molson's Bank	4,000,000	5,000,000	9,000,000	66,653,901
1872	1923	Bank of Hamilton	5,000,000	4,850,000	9,850,000	67,904,128
1907	1923	Home Bank of Canada	1,960,591	550,000	......	27,404,709
1860	1924	Banque Nationale	2,999,700	2,200,000	5,199,700	49,870,951
1865	1925	Union Bank of Canada	8,000,000	6,000,000	14,000,000	130,922,739
1905	1925	Sterling Bank of Canada	1,235,000	500,000	1,735,000	20,845,201

Compilation of losses of Canadian bank shareholders and creditors is rendered difficult by the ception ought to be available and free are without information on important happenings of the liquidations of failed banks.

Losses to shareholders of failed, absorbed or liquidated banks, above computed consist of loss to Reserve Funds; and double liability to the percentage of capital ordinarily collectible. Losses loss through which cannot be estimated.

The generally accepted definition of bank failure has been restricted; otherwise the list of *Capital that has resulted in loss of identity of the Bank.*

H. C. Mc Leod,
August, 1926.

ARRANGED ACCORDING TO YEAR OF CLOSING (*Continued*)

Shareholders' Losses			Loss to Shareholders on all counts	Loss to Creditors	Independent Life: Years	Notes
Failed $	Absorbed $	Liquidated $	$	$		
.....	618,000	.....	618,000	......	41	
.....	......	4,191,000	......	Not publ'ed	47	
.....	82,776	.....	82,776	......	35	Including losses 1878 and Directors' contributions
.....	......	.....	......	......	38	Bought by Bank of Montreal
334,145	......	.....	334,145	400,000	35	Estimated. Information not published
326,386	......		326,386	340,000	35	
.....	....	7,600,000	......	3,300,000	7	Particulars of losses are not available to the public. Estimated from reliable data
.....	......	.....	......	......	4	
.....	......	.....	......	......	3	
.....	......	.....	......	......	32	
.....	182,000	.....	182,000	......	54	
260,000	......	.....	260,000	......	74	
.....	———	.....	....	......	5	Absorbed by Union Bank of Canada
800,000	......	.....	800,000	1,400,000	4	Losses are estimated. Information not published
.....	———	.....	......	......	52	Absorbed by Can. Bank of Commerce
.....	———	.....	......	......	27	Absorbed by Royal Bk.
.....	———	.....	......	......	93	Absorbed by Bank of Nova Scotia
.....	......	.....	......	......	2	Loss included with Home Bank
.....	......	.....	......	......	12	Absorbed by Bank of Nova Scotia
600,000	......	.....	600,000	300,000	4	Losses estimated. No information available to the public
.....	......	.....	......	......	99	
.....	1,734,000	.....	1,734,000	......	83	
.....	675,118	.....	675,118	......	10	Absorbed by Royal Bk.
.....	......	.....	......	......	44	Ottawa Shareholders receive $512,000 dividends yearly from Bank of Nova Scotia instead of $480,000 under former conditions
.....	11,266,443	.....	11,266,443	......	58	Including loss to shareholders in 1878
.....	3,266,666	.....	3,266,666	......	68	
.....	......	.....	......	......	51	Absorbed by C. B. of C. by exchange of shares
2,500,000	......	.....	2,500,000	11,000,000	16	In course of liquidation Govt. seemingly admits liability to creditors
.....	2,199,700	.....	2,199,700	......	64	The Government of Quebec was impelled to deposit $15,000,000 bonds, the amount to be payable out of future profits
.....	6,800,000	.....	6,800,000	....	60	Including loss of Capital funds in 1886
.....	417,000	.....	417,000	....	20	
			58,798,326	23,558,320		

lack of records. Even the Finance Department of Canada, where details of banking from its in-
recent past, and no means are taken to inform the people regarding the process of important

or impairment of: Capital reported as paid in during the Bank's life; profits reported as passed
to creditors are prone to be under stated — through sacrificing of claims at low figures — the

failures would be lengthened. The definition of "failure" herein adopted is — *Impairment of*

Bank Mergers. In Mr. McLeod's table 76 banks are listed as disappearing either through failure or absorption by other institutions. While bank failures as a cause for fewer banks forms a large topic by itself and will be discussed in a later section,[74] the subject of mergers may appropriately be treated now in the course of our discussions of the Bank Act, to which Sections 99–111 are devoted, but before proceeding to do this, the following table giving the names of the purchasing and absorbed banks is inserted as a matter of historical interest.[75]

BANK ABSORPTIONS IN CANADA SINCE 1867

Purchasing Bank	Bank Absorbed	Date
Bank of Montreal	Exchange Bank, Yarmouth, N. S.	Aug. 13, 1903
	Peoples' Bank of Halifax, N. S.	June 27, 1905
	Ontario Bank	Oct. 13, 1906
	Peoples' Bank of New Brunswick	April 15, 1907
	Bank of British North America	Oct. 12, 1918
	Merchants Bank	Mar. 20, 1922
	Molsons Bank	Jan. 20, 1925
Canadian Bank of Commerce	Gore Bank	May 19, 1870
	Bank of British Columbia	Dec. 31, 1900
	Halifax Banking Company	May 30, 1903
	Merchants Bank of P. E. I.	May 31, 1906
	Eastern Townships Bank	Feb. 29, 1912
	Bank of Hamilton	Dec. 31, 1923
Bank of Nova Scotia	Union Bank of P. E. I.	Oct. 1, 1883
	Bank of New Brunswick	Feb. 15, 1913
	The Metropolitan Bank	Nov. 14, 1914
	Bank of Ottawa	April 30, 1919
Royal Bank of Canada	Union Bank of Halifax	Nov. 1, 1910
	Traders Bank of Canada	Sept. 3, 1912
	Quebec Bank	Jan. 2, 1917
	Northern Crown Bank	July 2, 1918
	Union Bank of Canada	Aug. 31, 1925
Imperial Bank of Canada [1]	Niagara District Bank	June 21, 1875
Standard Bank of Canada [76]	Western Bank of Canada	Feb. 13, 1909
	Sterling Bank of Canada	Dec. 31, 1924
Banque d'Hochelaga	Banque Nationale	April 30, 1924
Bank of New Brunswick	Summerside Bank	Sept. 12, 1901

[74] See pp. 478–484.

[75] Source: *The Canada Year Book*, 1925, p. 842. The purchasing banks named in latter part of table are no longer in business. Dates given since 1900 are of the Orders-in-Council authorizing the absorption.

[76] Absorbed by Canadian Bank of Commerce on July 13, 1928.

Merchants Bank of Canada	Merchants Bank	Feb. 22, 1868
	Commercial Bank of Canada	June 1, 1868
Union Bank of Halifax	Commercial Bank of Windsor	Oct. 31, 1902
Northern Crown Bank	The Northern Bank	July 2, 1908
	Crown Bank of Canada	July 2, 1908
Union Bank of Canada	United Empire Bank	Mar. 31, 1911
Home Bank of Canada	La Banque Internationale du Canada	April 15, 1913

Of the banks taken over since 1867, seven each have been absorbed by the Bank of Montreal, and the Bank of Commerce, four by the Bank of Nova Scotia, and five by the Royal Bank. These four institutions account for 23 out of the 34 banks absorbed since Confederation. This does not include the institutions absorbed by these 23 banks before they were merged with one of the " big four." When these are included the " big four " account for 31 out of 34 mergers.

Opposition to Mergers. Sections 99–111 of the Bank Act contain elaborate provisions governing bank mergers, the procedure to be followed and the legal liabilities of the shareholders. For the student of banking, the most significant provision probably is that requiring the consent of the Governor-in-Council, as recommended by the Minister of Finance and the Receiver General, before a merger may take place. This was inserted in the 1913 revision to appease those who feared that the rapidly declining number of banks would lead to the establishment of a " money trust." Vigorous opposition to further mergers was voiced in Parliament and in the Banking and Commerce Committee, both in 1913 and again in 1923, and even from time to time among some bankers.

The remarks of Mr. W. F. Maclean, one of the " radical " members of the Banking and Commerce Committee in 1923, typify the sentiments of many toward this problem: [77]

" I should like to ask the Minister of Finance whether in his opinion it is not in the interest of the public that there should be competition in banks as well as in all other organizations. The

[77] *House of Commons Debates,* June 20, 1923, p. 4135. See also *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 893.

whole tendency is in the direction of mergers and I must say that I would look upon the movement with some degree of favour if we should see established a Bank of Canada. Such an institution would be a national bank, and more or less associated with smaller concerns. Something in that direction may be effected which would serve the interests of the public. Apparently, however, the tendency is to remove the competition that now exists in banking. Heretofore we have had a great many banks in this country serving the public, and when those desirous of getting accommodation cannot get service at one they may go to another."

Reasons for Mergers. Contrary to the implication carried in the address of Mr. W. F. Maclean, mergers have not come about as the result of sinister premeditations on the part of the banking community aiming toward a "money trust" or with the avowed object of stifling competition. While the merger movement may result in a money monopoly, and William Long Baker in his work, "Money Monopoly vs. the Community Dollar," believes that such has been the case, yet this was not the motivating factor in the movement. Mergers have in most cases resulted from the fact that a bank was rapidly approaching an insolvent condition or had reached a point where (perhaps through absence of aggressive management) it was unable to compete successfully with the larger institutions. The initiative for the mergers did not proceed from the large institutions but from the smaller banks aware of their approaching insolvency or inability to keep in the race. This point was stressed by both Mr. Maclean of Halifax, chairman of the Committee on Banking and Commerce, and by Mr. Fielding, the Minister of Finance, in addresses before the House of Commons in 1923.

Mr. Maclean spoke as follows: [78]

"We are dealing with a clause relating to the purchase of the assets of a bank. People designate this as a "merger," and this word has been made unpopular, being often unfairly and improperly used. Hon. gentlemen talk about a merger as if it were a thing that could be prevented. The Minister of Finance has stated the government's policy, which is a sound one, namely, that it is not disposed to consent to the merging of banks each of which oc-

[78] *House of Commons Debates,* June 20, 1923, p. 4138.

cupies a sound position merely for the sake of their being merged or for the sake of profit-making. But we must have in this act some provision whereby a bank may purchase the assets of another bank. Most mergers that have taken place in Canada were induced by the fact that the selling bank was in, or approaching, an insolvent position and the management were not disposed to carry on business further. It is in the interests of depositors and shareholders that there be a legal procedure to dispose of the assets of one to another."

In his address, Mr. Fielding cited the case of a bank merger taking place because the directors realized that the financial success of the institution was on the wane: [79]

"I have in mind the case of a merger which is not by any means recent, having occurred some years ago, in connection with which the bank that was absorbed was entirely solvent when turned over to the other bank — it was not insolvent, nor indeed was it on the edge of insolvency. The Directors, capable business men, reviewing the whole situation, saw however that the bank was on the decline, and that the day was coming when it could not be successful."

Undoubtedly, however, there has been rivalry between the big Canadian banks in the matter of bidding for banks which were willing and secretly anxious to merge, and this competition has made possible deals more favorable to the selling institution. This raises the question whether mergers have on the whole resulted favorably for the shareholders of the purchasing institutions and whether some bank stock would not now be more valuable if the same energy devoted to increasing size were devoted to concentrated and capable management. Personal ambitions may overlook at times, unwittingly perhaps, the ultimate good of the shareholders.

Attitude of the Bankers Toward Mergers. The bankers testifying before the Committee on Banking and Commerce of the House of Commons in 1923 took rather an extreme position. Not only had the mergers of the past, in their opinion, been most desirable but in all probability this tendency would continue and

[79] *House of Commons Debates,* June 20, 1923, p. 4139.

would be of increasing benefit to the country. It is true that the statements about to be quoted may not represent the concensus of opinion among all bankers, but they are of importance in reflecting the reaction of the officials of the larger and more influential institutions. In his testimony Sir Frederick Williams-Taylor, General-Manager of the Bank of Montreal and President of The Canadian Bankers' Association, declared that mergers could go on for some time without unduly centralizing the money power of the Dominion: [80]

Q. There has been, Sir Frederick, in the last twenty years a centralization of the money power of the Dominion, has there not? For instance, if I were to turn back the pages of history twenty or thirty years ago we would find twenty-eight banks operating and today there are seventeen; the tendency is for that to go on? —

A. Yes, I should think it would continue, with the permission, of course, of the Minister of Finance.

Q. Is that a good thing? — A. I think it is a very good thing to eliminate a weak bank.

Q. Do you think it is a good thing that there should be an increasing centralization of the money power of this country in the hands of a decreasing number of organizations? — A. I do not think we have reached the point where there is any possible danger at present.[81]

During his examination Sir Edmund Walker, President of the Canadian Bank of Commerce, stressed before the Committee the economies resulting from amalgamation, through lessened overhead expense. While data are not available to prove or disprove his contention, yet the point might well be raised whether a large bank, grown to huge proportions as a consequence of many mergers, does really operate proportionately at as low a cost as a smaller institution. Its very size is apt to make for a loose organization, to make adequate oversight increasingly difficult and to

[80] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 314. See also the statement by Mr. C. E. Neill, *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 261, and for a further defense of mergers an article by Fraser Dorward, in the *Monetary Times,* Vol. 72, p. 10.

[81] See table on pp. 330–333 for statistics of bank concentration.

make losses from lending operations large. A more moderate view than that of Sir Frederick Williams-Taylor or Sir Edmund Walker of the desirability of bank mergers was expressed by the Bank of Toronto in its annual report for 1924.[82] Its statement is worthy of particular attention as this institution has never been involved in a merger and has no vested interest to defend. It places the necessity or blame for mergers squarely on excessive rivalry and over-competition and hopes that bank amalgamations will place banking credits on a better footing:

Two bank mergers have been announced during the year, which will reduce the number of chartered banks to twelve — still quite enough to provide all the competition desirable, and more. There has certainly been excessive rivalry in the banking field during the past twenty years, resulting in unnecessary duplication of banking services. Over-competition in any line of business is bad, but it is worse in banking than elsewhere. The practice of bidding for business follows, involving, in some cases, a departure from good banking — in the direction of excessive advances on inadequate security — almost invariably a bad thing for both borrower and lender. If the combinations which have taken place during the last few years enable banking credits to be placed on a better footing, with better earnings and smaller losses, only good can result, not only to bank shareholders but to the general public.

Attitude of Government Toward Mergers. Generally speaking, the Canadian Government does not look with favor upon mergers unless these are urgently necessary to protect the depositors or stockholders from loss. Its policy very definitely is not to grant permission if the purpose is one of reducing competition. Before applying formally for permission, a bank desiring to sell its assets to another institution will often approach the Minister of Finance in an informal fashion to ascertain his attitude. In case he intimates that he would be opposed, no formal application would be submitted.[83] If, on the other hand, he is convinced of the urgency of the case and of the absolute need of

[82] P. 9.

[83] See speech of Mr. Fielding, *House of Commons Debates*, June 20, 1923, p. 4134.

the merger as a means of preventing failures, he would communicate with the Bankers' Association and with the larger banks in an effort to find a purchasing bank. In this connection Sir Thomas White, a former Minister of Finance, stated most emphatically that the Finance Minister has the power, moral if not legal, to compel the existing banks to take over an institution approaching insolvency: [84]

Q. Now at page 324 in No. 5, you say at the top of the page: — " Under no circumstances would I have allowed a bank to fail during the period in question." Now I would ask you, if you found a bank in difficulties, if it had been shown to you at that time that the Home Bank was in serious difficulties, what would you have done to prevent its failure? — A. If I had believed that the Home Bank at that time was in danger of failing, closing its doors, was insolvent, I should have gone to The Canadian Bankers' Association and told them to take over that bank. Either to one bank or more banks.

Q. And what is your opinion as to what they would have done? — A. I think they would have looked into the situation, and on the situation, or anything like the situation that was before me, they would have done it. I think I would have made them do it.

Q. If the bank was not too far gone? — A. Yes. I would have made them do it. When I say that, I had no legal power, but nevertheless I feel confident that I could have got them to do it, because it was in the midst of the war and if I had believed that that bank was in danger of insolvency or about to close its doors, I would have said to The Canadian Bankers' Association: " You take over that bank."

Q. If you had known then what you do now, you would have done that, I suppose? — A. Absolutely.

Whether the Finance Minister can take the positive action outlined by Sir Thomas White, there is no doubt but that the Government's policy is to prevent any merger unless there is real

[84] *Royal Commission to Inquire into and Report upon Affairs of the Home Bank of Canada*, p. 359. The question naturally arises why this power was not exercised in connection with the Home Bank.

justification. Thus Mr. Fielding, then Minister of Finance, stated in the House of Commons: [85]

"I am quite prepared to admit that there may be need in the future of some mergers. I think as a rule they should be discouraged, but circumstances may arise which may render a merger necessary and proper. It has been suggested that a merger should only be made by a special act of parliament. I could not approve of that because the circumstances under which a merger may be deemed necessary may be very urgent, and to wait until parliament could convene might be to destroy the possibility of the merger going through and to lead to serious trouble. I am not anxious to promote mergers unnecessarily, but I cannot conceive of any arrangement that could be made which would be better than that which we already have. . . . If it were a case of two large banks where the amalgamation involved a diminution, a material diminution, in competition, it might be held there is no particularly good reason for the merger except some profit-making motive; there might be no public reason which would indicate its necessity."

Mr. Meighen, the leader of the opposition, was even more emphatic than Mr. Fielding, and expressed his conviction that the attitude of the Government toward mergers should be as antagonistic as possible: [86]

"In my judgment, the fewer mergers we have the better, that is, of the banks that we have to-day. My information is that in England they have fewer than we have in Canada, although they have a much larger population. Of course they have a somewhat different system. But the fewer we have the better, and the more adverse the attitude of the government and the Minister of Finance is toward mergers, the better for us. At the same time I quite admit that the Hon. member who has just sat down is correct when he says that there comes a time when merging is the only way that can prevent very great hardship to shareholders or possible loss to depositors — in a word, to prevent the very things which the safeguards of the Bank Act are intended to prevent.

[85] Debates, June 20, 1923, p. 4134.

[86] *House of Commons Debates,* June 30, 1923, pp. 4138–4139.

But it should be the last resort, and the very last resort; and the bank should understand that such is the attitude of the government. It should understand that it is only as a rescue from inevitable insolvency that a merger can be assented to. I can think now of no other justifiable case."

Conclusions Regarding Mergers. In reaching any conclusion regarding bank mergers in Canada, it must be borne in mind that the tendency toward fewer and larger banks is one to be found in all " advanced " industrialized nations. And also it should be remembered that it is a phenomenon not to be found in banking alone but in industry and commerce as well. In fact, a frequent excuse given for bank amalgamations is that the larger business units must be supported by larger financial aggregates. Whether these aggregates will, as Karl Marx predicted, be finally nationalized and operated by the Government, as in Russia at present, need not concern us at this point. The problem of immediate interest is the policies which should be followed, the attitude to be adopted by governments in capitalistic societies toward mergers. The Canadian Government has put itself on record as being in distinct opposition unless there is a " real need." But the situation calls for more than a negative attitude on the part of the Canadian Government. The Government should, as one constructive measure, exercise such careful supervision over the banks, subject them to such careful inspection, that the possibility of failure, and of that as a cause of mergers, is reduced to a minimum. Any such episode as the Merchants Bank debacle should not, now that there is an Inspector General of Banks, be allowed to develop. Even assuming that the Government were able to prevent such episodes, and thereby eliminate a state of approaching insolvency as a cause of mergers, this would but retain or perpetuate the *status quo*. The present situation with four banks of disproportionate size would continue. The big banks are here. What is to be done? And one is forced to confess that little can be done, that the Government must needs adopt a policy of " watchful waiting." Rigid supervision and examination can be enforced. And beyond this, little remains unless the Government feels that portions of the community are not getting the credit to which they are entitled, that there are un-

justified levies on the public, or other abuses. Whereupon, it could organize on its own initiative or through controlled corporations competing credit institutions, or it might set up commissions as recommended by Professor D. A. McGibbon[87] which would have much the same authority over banks, the extensions and cost of credit as that exercised by the Interstate Commission in the United States over the railroads. All of which probably seems inconclusive and indefinite and necessarily so in treating of a subject in which problems can be solved only as the situation arises.

Capital Requirements. In case the charter is favorably acted upon by Parliament, letters of incorporation are then granted, and after ten days' public notice, the provisional directors may cause the stock books to be opened for public subscription. Whenever the sum of $500,000 of the authorized capital has been bona fide subscribed (which must be done within a year's time) and payments in money on that account have been made by subscribers to a total of not less than $250,000,[88] the directors shall apply for a certificate from the Treasury Board (consisting of the Minister of Finance, the Receiver General, and four ministers belonging to the King's Privy Council for Canada as nominated by the Governor-General) to commence business.

The requirements in the Canadian banking law of a subscribed capital of $500,000 and of a paid-in-capital of $250,000 is much above the minimum capital requirements for national and state banks in the United States. In the case of national banks the minimum capitalization allowed is $25,000 for towns of 3000 and less. In the State of Tennessee commercial banks may be organized in localities of 1500 or less with as small a capital as $7500. This apparently is the rock-bottom figure. A little higher in the scale are a number of States, Alabama, Arkansas, Colorado, Kentucky, Minnesota, Mississippi, Missouri, and Oklahoma, which allow banks to be organized in small centers with a capital of $10,000. The adequacy of the capital requirements set by Canadian law cannot be judged by quoting the minimum allowed by

[87] *Report of the Commissioner on Banking and Credit with Respect to the Industry of Agriculture in the Province of Alberta,* 1922, pp. 47–48.

[88] The provisional directors must place in trust $250,000 with the Minister of Finance in order that he may be assured that this amount has been paid in on the stock subscribed.

Federal or State law in the United States, for once a bank is organized in Canada it may have branches anywhere. The privilege of establishing branches even to a limited and restricted extent in the United States is enjoyed only in exceptional instances. In only a few states are banks allowed to establish branches outside of the city in which the head office is located. When the capital requirements of those states are studied, the Canadian figures do not seem so high. In California, for example, a commercial bank in localities of 200,000 or over (which if applied to Canada would include Toronto and Montreal where the chief operating offices of all but one of the banks are located) must have a minimum capital of $300,000 and $25,000 in excess of the minimum for each branch opened in the place where the principal business of a bank is transacted, and for each branch established in another locality the minimum must be increased by the amount required for banks in that locality. Besides California, there are ten states which definitely permit state-wide branch banking. The capital required in these states in towns the size of Toronto or Montreal and the additional increment for each branch established are given in the following table:

Name of State	Capital Required	Additional Increment
Arizona	$200,000	$15,000 (additional capital and surplus).
Delaware	....	A capital of $25,000 is required for each place of business and proposed branch and a surplus of at least $25,000 for each place of business in operation.
Georgia	50,000	At discretion of banking superintendent, not less than amount of capital required to organize a unit bank in place where branch is opened.
Maryland	200,000	Same provision as in case of Georgia.
North Carolina	100,000	Same provision as in case of Georgia.
South Carolina	25,000	No provision.
Rhode Island	....	Only provision is that commercial deposits must not exceed ten times combined capital and surplus.
Tennessee	50,000	No provision.
Virginia	25,000	No provision.
Wyoming	100,000	No provision.

In the following table the chartered banks are listed in the order of their paid-up capital, which, as it so happens (with the ex-

ception of the Royal Bank), is also the order of their authorized and subscribed capital. It will be noted that none of the banks have an authorized capital as small as that permitted by law. The authorized capital of the Weyburn Security Bank, the smallest of all, is twice the legal minimum. It will also be noted that the paid-up and subscribed capital of each bank is identical excepting in the case of the Royal Bank and the Weyburn Security Bank. The authorized capital is in all cases larger than the paid-up capital and largest relatively in the case of the Bank of Toronto: [89]

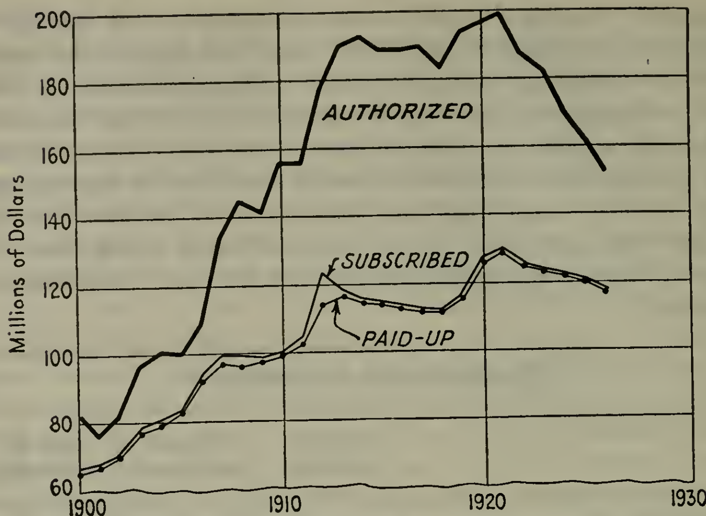
The Capital of the Chartered Banks

	Paid-Up Capital	Capital Authorized	Capital Subscribed
Bank of Montreal	$29,916,700	$31,175,000	$29,916,700
Royal Bank of Canada	29,738,450	40,000,000	30,000,000
Canadian Bank of Commerce	20,000,000	25,000,000	20,000,000
Bank of Nova Scotia	10,000,000	15,000,000	10,000,000
Imperial Bank of Canada	7,000,000	10,000,000	7,000,000
Dominion Bank	6,000,000	10,000,000	6,000,000
Banque Canadienne Nationale	5,500,000	10,000,000	5,500,000
Bank of Toronto	5,000,000	10,000,000	5,000,000
Banque Provinciale du Canada	4,000,000	5,000,000	4,000,000
Weyburn Security Bank	524,560	1,000,000	655,700

The chart shown at the top of the next page presents, since 1900, fluctuations in the authorized, subscribed, and paid-up capital of the chartered banks. The maximum point in all three curves was reached in 1921, since then there has been a drop of 47 millions of dollars in authorized capital and of 12 millions of dollars in paid-up capital.[90]

Surplus Requirements. The only provision appearing in the Act regarding the building up of a surplus fund is Section 59 which limits the payment of dividends to 8% per annum unless the surplus is equal to 30% of the paid-up capital after providing for all ascertained and estimated losses. As a matter of fact, the accumulated surplus of each of the chartered banks is considerably

[89] Source: *Return of the Chartered Banks,* July 30, 1927.
[90] Source of data: *Returns of the Chartered Banks.* Data as of the last banking day in July of each year.



A Comparison of the Authorized, Subscribed and Paid-up Capital of the Chartered Banks

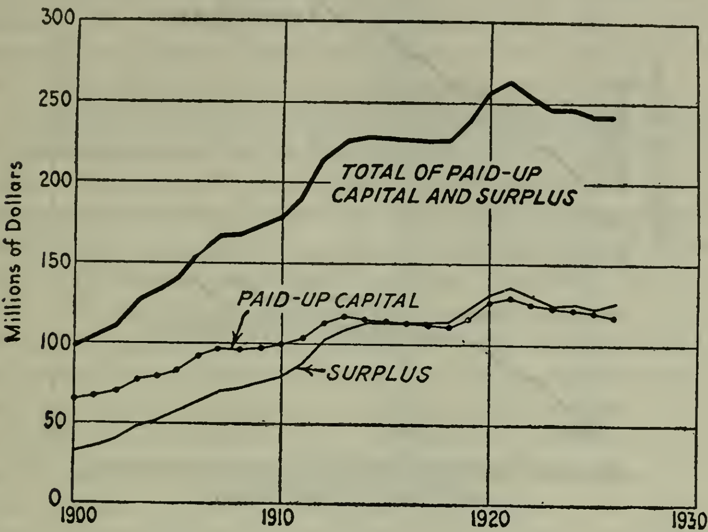
larger than the requirement. In the case of all but three it is equal to at least 100% as shown in the following table which lists the banks in the order of the relative magnitude of their surplus funds:

Surplus and Paid-Up Capital of the Chartered Banks as of July 30, 1927 [91]

Name of Bank	Surplus	Paid-up Capital	Ratio of Surplus to Paid-Up Capital
Bank of Nova Scotia..........	$19,500,000	$10,000,000	195%
Bank of Toronto..............	7,000,000	5,000,000	140
Dominion Bank..............	7,000,000	6,000,000	116.6
Imperial Bank................	7,500,000	7,000,000	107.1
Bank of Montreal.............	29,916,700	29,916,700	100
Canadian Bank of Commerce...	20,000,000	20,000,000	100
Royal Bank of Canada........	29,738,450	29,738,450	100
Banque Canadienne Nationale..	5,500,000	5,500,000	100
Standard Bank of Canada.....	2,900,000	4,823,400	60.1
Weyburn Security Bank.......	225,000	524,560	42.5
Banque Provinciale du Canada.	1,500,000	4,000,000	37.5

91 Source of data: *Returns of the Chartered Banks,* July 30, 1927.

Rather an interesting feature of the Canadian banking system has been the greater rapidity in the growth of surplus since 1900 as compared with capital. This fact is illustrated in the accompanying chart.[92]

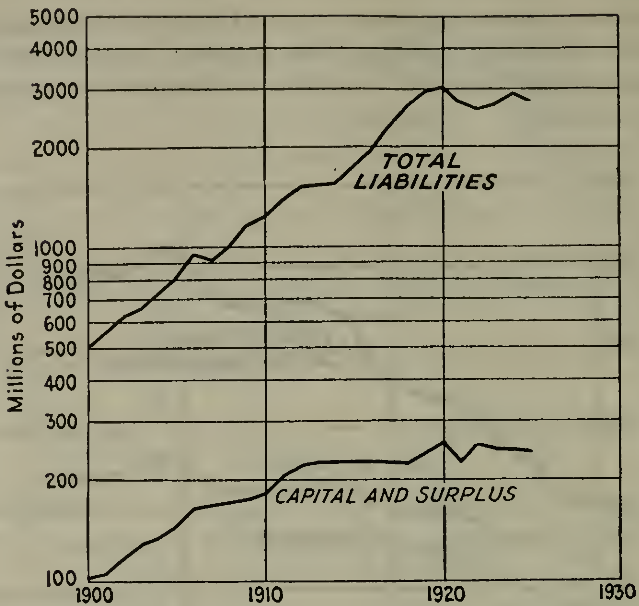


TREND OF PAID-UP CAPITAL AND SURPLUS

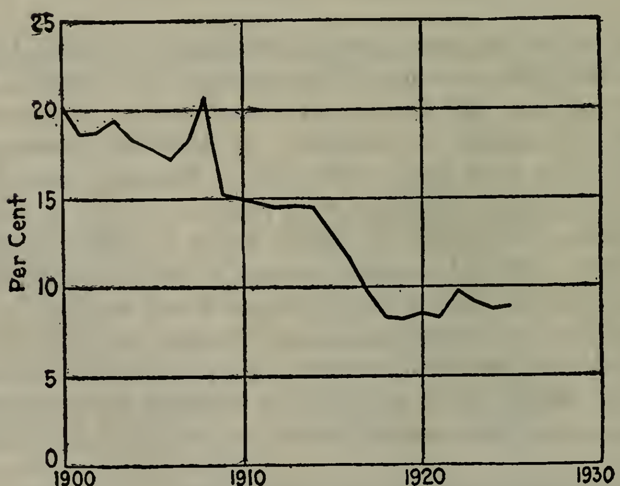
DECLINE IN RATIO OF CAPITAL AND SURPLUS TO TOTAL LIABILITIES. One of the most disturbing features of the Canadian banking system since 1900 has been the steady decline in the ratio of capital and surplus to liabilities. In 1900 this amounted to slightly more than 20%, while now it fluctuates around 9%. The most precipitous decline took place in the war period, the ratio falling from 14.59% in 1914 to 8.21% in 1920, which is accounted for by the phenomenal increase in liabilities during those six years with no proportionate increase in net worth.

The failure of Canadian banks to increase their net worth as their liabilities expanded has had one quite significant result in reducing the potential expansibility of their note circulation which, prior to 1908, could not exceed the amount of their paid-up

[92] Source of data: *Returns of the Chartered Banks.* Data are given as of the last banking day in July of each year.



Relative Growth of Total Liabilities and Capital and Surplus (Ratio Scale)



Per Cent of Capital and Surplus to Total Liabilities

capital. In fact, the expansive power became so impaired that the banks found difficulty in meeting the autumnal pressure, and as a consequence an amendment was enacted in 1908 permitting a larger or emergency circulation during the crop-moving periods.[93] The bankers in their testimony before the Committee on Banking and Commerce in 1913 explained their failure to increase their capital to their inability to sell bank stock to keep pace with a rapidly growing population.[94]

The decline in the ratio of net worth to liabilities again received serious consideration by the Banking and Commerce Committee in 1923. Sir Edmund Walker attempted to explain this decline on the ground that the banks had been over-capitalized previously [95] and that they were unable to make sufficient earnings to pay attractive dividends on their stock and that the decline had come about as a natural readjustment of business to capital. As a further justification or rationalization he made the point that the liabilities of the great British banks were larger in proportion to their capital than the liabilities of the Canadian banks. Be that as it may, Sir Edmund Walker's explanation does not cover the rapid decline during the war inflation period and, all in all, it is a most unhealthy tendency in Canada and elsewhere. In the table shown at the top of the next page, the chartered banks are listed in the order of the relative size of their capital and surplus to total liabilities.[96]

[93] For further discussion, see *The Canadian Banking System,* by J. F. Johnson, pp. 130–131, also, *Interviews on the Banking and Currency Systems of Canada* (National Monetary Commission, U. S. A.), p. 71 and *Minutes of Proceedings, Evidence,* etc., 1913, pp. 258 and 640. See also pp. 381–385 in this chapter.

[94] In his testimony in 1913, (*Minutes of Proceedings, Evidence,* etc., p. 558), Sir Edmund Walker presented a table giving data regarding the shares of the Canadian Bank of Commerce owned in the different Provinces of Canada and abroad.

[95] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, pp. 528–529.

[96] *Returns of the Chartered Banks,* July 30, 1927.

Name of Bank	Capital Paid-Up	Surplus	Total Liabilities	Ratio of Capital & Surplus to Liabilities
1. Bank of Nova Scotia	$10,000,000	$19,500,000	$248,387,329	11.9
2. Weyburn Security Bank..........	524,560	225,000	6,453,518	11.6
3. Banque Provinciale du Canada.....	4,000,000	1,500,000	49,841,687	11.0
4. Imperial Bank of Canada	7,000,000	7,500,000	133,302,821	10.9
5. Dominion Bank . .	6,000,000	7,000,000	128,503,643	10.1
6. Bank of Toronto . .	5,000,000	7,000,000	122,415,365	9.8
7. Canadian Bank of Commerce	20,000,000	20,000,000	489,849,138	8.2
8. Bank of Montreal.	29,916,700	29,916,700	769,180,668	7.8
9. Royal Bank of Canada........	29,738,450	29,738,450	772,473,639	7.7
10. Banque Canadienne Nationale .	5,500,000	5,500,000	147,994,969	7.4

Directors — Qualifications. The Bank Act specifies that the Board of Directors of each chartered bank is to be elected at the annual meeting of shareholders held at the chief office of the bank. The minimum number to be chosen is not specified by law, as in the case of National Banks in the United States, which must have at least five. A majority of the board, whatever number it may consist of, must be natural-born or naturalized subjects of His Majesty and domiciled in Canada. Each director must own a certain amount of stock and, as indicated in the following table, the amount of stock to be owned is proportioned to the paid-up capital of the bank:

Minimum Amount of Stock Required to be Owned	Paid-Up Capital of Bank
Par Value	
$3000	$1,000,000 or less
4000	1,000,000 to 3,000,000
5000	3,000,000 or over

The directors ordinarily own considerably larger blocks of stock than required by law. In the case of the Bank of Montreal, the by-laws require a holding of at least 100 shares. The following table will give an idea of the shareholdings of the directors of seven of the chartered banks:

Name of Bank	Number of Directors	Shares Owned by			
		President	General Mgr.	Others	Average Holdings of Directors
Bank of Nova Scotia..........	16	546		From 75 to 786	363 (as compared with average holdings of all shareholders of 24.7 shares)
Bank of Toronto ..	12	1186	130	From 60 to 200	191
Canadian Bank of Commerce......	30	200	(Not a member of the Board)	From 50 to 656	146
Dominion Bank...	10	1000	400	From 100 to 565	401
Banque Canadienne Nationale	11	400	(Not a member of the Board)	From 100 to 500	225
Imperial Bank of Canada	9	243[97]	...	From 50 to 500	...
Weyburn Security Bank	7	400	...	As high in one case as 800 shares	...

Generally speaking, the directors are drawn from various sections of the country, in a few cases, from foreign countries, and

[97] The president's firm in which he is the chief partner owns 590 shares.

are representative of all leading forms of business activity. To give an idea of the geographical distribution of the boards, the accompanying table is inserted giving the domicile of the directors of the Canadian Bank of Commerce:

Domicile	Number of Directors
Toronto	8
Hamilton	6
Montreal	5
Winnipeg	5
Halifax	1
Ottawa	1
Victoria	1
New York	1
Chicago	1
Rio de Janiero	1
Total	30

Powers of Directors. The directors are granted power to make by-laws and regulations not inconsistent with the Bank Act in respect to:

(a) The management and disposition of the stock, property, and affairs and concerns of the bank.
(b) The duties, remuneration, and the bond or guarantee to be required of the officers and employees.
(c) All other matters as may appertain to the business of the bank.

From among their own number the directors elect a chairman and one or more vice-chairmen, with the titles of President and Vice-President respectively.[98] The officer corresponding to the president of a national bank in the United States bears the title of General Manager, and though he is in some cases a member of the board this is not required by law.

Duties of Directors. At the annual meeting of the share-

[98] Usually honorary positions though, in a few instances, General-Managers have been elected as President and continued as active executive officers.

holders the outgoing directors, who are eligible for reëlection, must submit a clear and full statement of the affairs of the bank, presenting the assets and liabilities and profits and loss account as well as similar statements of any corporation in the name of which the bank carries on any part of its operations. Further, as evidence (of more or less value) of the directors' interest in the affairs of the bank, a record of their attendance is mailed yearly to each shareholder. In case directors live at such distant points as to be unable to attend, a statement of the nature of their contribution to the institution may be inclosed.

Bank Management in Canada. In a chapter of this length, dealing primarily with the broad phases of the Canadian banking system and with the rôle it plays in the economic and industrial organization of the Dominion, any lengthy discussion of the technique of banking, of bank management or organization, would be out of place. These are admittedly topics of importance and of widespread interest, and might well be developed in separate treatises.

Branches of the Chartered Banks. To the banker and student of banking in the United States, involved or interested as he may be in the branch bank controversy, the most engrossing feature of the Canadian banking system is the network of branches stretching across the Continent. Years ago the note issue privileges of the chartered banks occupied the center of interest, but this has passed now that the Federal Reserve note has injected the needed elasticity into the American currency system. The question of city branch banking is today in the limelight and looming important in discussions of economists and bankers and in Congress.[99] Though the United States has what is commonly termed a unit independent type of banking system, which means that the typical bank has no branches, it is interesting to note that at the time of the establishment of the Union the tendency was towards branch banking. The first Bank of the United States incorporated by an act sponsored and approved by the fathers of the country, with its head office in Philadelphia, had as many as 8 branches in other important centers. Even those who op-

[99] For a discussion of the branch bank question see Volume VI, Chapter XIII, of *Banking Inquiry, 1925,* filed by Dr. H. Parker Willis with the Committee on Banking and Currency, United States Senate, 1926.

posed the act on the ground that it was unconstitutional, did not oppose the branch bank provisions *per se* or claim that these were "un-American," a statement frequently used by opponents of branch banking at the present time. The second Bank of the United States organized in 1816, with its head office also in Philadelphia, had at one time or another as many as 27 branches, located in such remote, but yet important centers commercially, as New Orleans and Portland, Maine. Not alone did these Federal banks have branches but also many banks chartered by special state enactments such as the Bank of the State of Indiana and the Bank of Missouri had branches. The tendency before the Civil War was quite definitely in the direction of branch banking.

This development was checked by the passage of the National Bank Act which, while it did not prohibit branches, yet did not expressly give national banks this right. Owing to the heavy tax imposed on their note-issue privileges, state banks found it more profitable and expedient to surrender their state charters and to enter the national system as unit banks. The arresting of branch banking and the establishment of the unit-independent type of banking system, which may be laid at the doors of the National Bank Act, by hampering an easy flow of funds from section to section, occasioned the necessity for, and led to the establishment of, the Federal Reserve Banks which are themselves allowed to establish branches.

There is no uniformity, of course, in the state banking laws regarding branch banking. In ten States and the District of Columbia, state-wide branch banking is permitted.[100] Five States, Louisiana, Maine, New York, Massachusetts and Ohio, allow branch banking within certain geographic limitations. Four States, Kentucky, Mississippi, Michigan and Pennsylvania, allow banks to establish branch offices or agencies but not branches. In 29 States branch banking is not permitted either explicitly by law or by court decisions or administrative rulings. Diverse as are Federal and State laws on the subject of branch banking, the fact remains that branch banking to some extent does exist. And above all, public interest is more generally aroused on this subject that ever before.

[100] See page 348 for list of these states.

Source of Legal Authority for Canadian Branches. It is by Section 75 (a) of the Bank Act that the chartered banks are granted the very general power to open branches, agencies, and offices. This privilege extends not only to all sections of Canada but also to those foreign nations (England, Cuba, etc.) which by their own laws or official usage will permit Canadian banks to operate within their territory.[101] As the following table indicates, each of the chartered banks has taken advantage of this section and operates branches and does business in more that one Province excepting the Weyburn Security Bank which confines itself exclusively to Saskatchewan:[102]

NUMBER AND LOCATION OF BRANCHES OF CANADIAN BANKS (AS OF DECEMBER 31st, 1925)

Chartered Bank	Prince Edward Island	Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskatchewan	Alberta	British Columbia	Yukon	Other Countries	Sub-Agencies	Total
Bank of Montreal....	1	14	14	112	224	37	58	63	44	1	16	33	617
Bank of Nova Scotia..	9	38	36	19	126	8	14	5	6	–	38	22	321
Bank of Toronto.....	..	..	..	11	90	10	35	9	5	..	..	5	165
Banque Provinciale du Canada...........	3	..	15	98	17	..	..	..	..	..	..	203	336
The Canadian Bank of Commerce.........	7	20	6	63	169	49	87	53	54	2	16	23	549
The Royal Bank of Canada...........	7	63	24	66	250	80	147	82	54	..	126	24	923
The Dominion Bank..	..	..	1	5	86	11	5	5	3	..	2	1	119
Standard Bank of Canada...............	..	..	1	1	161	10	17	19	1	..	..	13	223
Banque Canadienne Nationale.........	..	..	..	211	20	10	7	6	..	..	1	329[103]	584
Imperial Bank of Canada...............	..	..	..	2	92	7	22	23	13	..	..	18	177
Weyburn Security Bank.............	..	..	..	..	..	..	26	..	..	..	..	..	26
Total............	27	135	97	588	1235	222	418	265	180	3	199	671	4040
Sub-agencies.....	4	5	11	512	103	11	8	9	7		1		
	31	140	108	1100	1338	233	426	274	187	3	200	671	4040

[101] New York State allows foreign banks to be represented by agents, upon receiving a license from the State banking department, but does not permit the receipt of deposits.

[102] This and the following table were furnished by Mr. Henry T. Ross, secretary of The Canadian Bankers' Association.

[103] Of these sub-agencies perhaps 320 are merely notaries who receive deposits but do no discounting or other business for the bank. In the

While the two so-called French banks operate in several Provinces, all but a small percentage of their branches and offices are concentrated in Quebec and for all practical purposes they may be termed one-Province banks. The remaining eight are truly national and four of them truly international in character. The Royal Bank, with its 797 domestic branches and sub-agencies, leads the rest, with the Bank of Montreal second and the Canadian Bank of Commerce third.

The foreign branches of the chartered banks are given in the table on the opposite page. Six at the present time have offices abroad and as an interesting sidelight, five of these have branches or offices in both England and the United States. The 126 foreign offices of the Royal Bank [104] concentrated for the most part in the West Indies, Central and South America, account for 63% of the foreign branches of all the Canadian banks.

Rapidity of Branch Expansion. The increase in the number of branches or banking offices in Canada, data for which are given in the table on page 362, has been most phenomenal in the past twenty-five years. In 1900 there were but 708 banking offices, or one for every 8000 persons, while in 1920, which marked the peak of war inflation, there were 4676, or one to every 1846 persons. While there has been a decline in the past six years in the number of banking offices, the total is still 5½ times the 1900 figure, so that even now there is one banking office for every 2450 persons.

Up to 1918 the number of sub-agencies maintained by the banks were not given separately in the data of branches. Most of these are located in Quebec, where a notary is appointed to receive deposits. In other Provinces a sub-agency means a point at which the bank is open for the receipt of deposits and the granting of

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case of the Canadian Bank of Commerce, the sub-agencies are open from one to four days a week, do a regular banking business, and are manned by employees sent from a near-by branch.

[104] The foreign business of the Royal Bank has been most profitable.

Number of Foreign Branches of Canadian Chartered Banks
(as of December 31, 1925)

Banks and Location	Number of Branches
Bank of Montreal	
Newfoundland	5
Great Britain	2
France	1
United States	3
Mexico	5
The Bank of Nova Scotia	
Newfoundland	12
Great Britain	1
United States	3
Jamaica	11 [105]
Cuba	7
Porto Rico	2
Dominican Republic	3
The Canadian Bank of Commerce	
Newfoundland	3
Great Britain	1
United States	4
Mexico	1
West Indies	5
Brazil	1
St. Pierre et Miquelon	1
The Royal Bank of Canada	
Newfoundland	5
Great Britain	1
France	1
Spain	1
United States	1
West Indies	92
Central and South America	25
The Dominion Bank	
Great Britain	1
United States	1
Banque Canadienne Nationale	
France	1
Total	200

[105] Includes one sub-agency.

HISTORICAL DEVELOPMENT OF BRANCH BANKING BY PROVINCES[106]

Dec. 31	Prince Edward Island	Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskatchewan	Northwest Territories	Alberta	British Columbia	Yukon	Total
1868	..	5	4	12	100	...	...	...	...	2	..	123
1889	6	47	32	60	231	13	...	4	...	9	..	402
1890	6	48	31	77	237	14	...	4	...	9	..	426
1891	6	51	32	94	247	21	...	8	...	9	..	468
1892	6	53	30	94	254	24	...	8	...	10	..	479
1893	6	58	29	102	263	24	...	8	...	12	..	502
1894	6	62	31	103	272	19	...	8	...	12	..	513
1895	6	62	31	115	275	20	...	8	...	13	..	530
1896	7	64	31	112	272	22	...	9	...	16	..	533
1897	8	69	31	114	269	29	...	11	...	24	..	555
1898	8	70	31	128	285	46	...	16	...	36	2	622
1899	9	74	34	113	321	50	...	19	...	41	2	663
1900	10	85	34	123	336	50	...	19	...	48	3	708
1901	9	89	35	137	349	52	...	30	...	46	3	750
1902	7	101	41	147	420	79	...	54	...	52	3	904
1903	11	99	47	183	491	87	...	78	...	50	3	1049
1904	10	101	49	196	549	95	...	87	...	55	3	1145
1905	11	100	50	246	701	127	...	150	...	66	3	1454
1906	14	106	54	270	845	166	...	209	...	78	3	1745
1907	14	104	55	297	929	163	...	231	...	90	3	1886
1908	16	104	58	311	918	162	...	252	...	103	3	1927
1909	16	106	67	342	962	175	207	...	156	130	3	2164
1910	15	111	72	368	977	188	273	...	192	168	3	2367
1911	15	111	74	396	1008	194	323	...	216	214	3	2554
1912	15	111	77	474	1062	204	375	...	255	237	3	2813
1913	15	109	75	536	1108	211	391	...	263	251	3	2962
1914	17	107	76	605	1144	208	401	...	258	230	3	3049
1915	17	109	79	716	1164	204	401	...	258	208	3	3159
1916	17	111	80	767	1146	199	399	...	245	193	3	3160
1917	18	115	82	615	1129	199	419	...	256	179	3	3015
1918	24	123	84	795	1165	254	506	...	307	178	3	3439
1919	36	155	111	1055	1451	322	581	...	408	215	3	4337
1920	41	169	121	1150	1586	349	591	...	424	242	3	4676
1921	40	166	122	1236	1574	329	549	...	396	244	3	4659
1922	36	156	127	1198	1521	304	524	...	356	226	3	4451
1923	30	150	128	1193	1443	271	481	...	320	208	3	4227
1924	33	141	124	1138	1401	249	452	...	299	200	3	4040
1925	31	140	108	1100	1338	233	426	...	274	187	3	3840

[106] Sub-agencies are included.

Sources: 1899–1908, *History of Banking in Canada* (National Monetary Commission), by Breckenridge, p. 310; 1909–1925: Mr. Henry T. Ross, Secretary of The Canadian Bankers' Association.

discounts for one, two or three days a week. The following table gives the number of branches and sub-agencies in Canada beginning with 1918: [107]

BRANCHES AND SUB-AGENCIES
(as of December 31 each year)

	1918		1919		1920		1921	
	Branches	Sub. Ag.	Branches	Sub. Ag.	Branches	Sub. Ag.	Branches	Sub. Ag.
Prince Edw. Isl...	24	...	35	1	38	3	36	4
Nova Scotia.....	123	...	145	10	162	7	161	5
New Brunswick..	84	...	103	8	109	12	109	13
Quebec.........	520	275	578	477	617	533	649	587
Ontario.........	1119	46	1339	112	1459	127	1430	144
Manitoba.......	240	14	292	30	320	29	307	22
Saskatchewan....	477	29	553	28	570	21	532	17
Alberta.........	297	10	382	26	402	22	372	24
British Columbia.	175	3	204	11	234	8	228	16
Yukon..........	3	...	3	...	3	...	3	...
	3062	377	3634	703	3914	762	3827	832
Foreign Branches	130	...	155	...	194	...	201	...
Foreign Sub-agencies...........	....	...	....	2	....	6	....	5
	3192	377	3789	705	4108	768	4028	837

	1922		1923		1924		1925	
	Branches	Sub. Ag.	Branches	Sub. Ag.	Branches	Sub. Ag.	Branches	Sub. Ag.
Prince Edw. Isl...	32	4	28	2	28	5	27	4
Nova Scotia.....	151	5	146	4	136	5	135	5
New Brunswick..	108	19	109	19	106	18	97	11
Quebec.........	631	567	632	561	611	527	588	512
Ontario.........	1396	125	1350	93	1303	98	1235	103
Manitoba.......	288	16	260	11	240	9	222	11
Saskatchewan....	505	19	477	4	448	4	418	8
Alberta.........	346	10	314	6	292	7	265	9
British Columbia	217	9	203	5	195	5	180	7
Yukon..........	3	...	3	...	3	...	3	...
	3677	774	3522	705	3362	678	3170	670
Foreign Branches	199	...	194	...	188	...	199	...
Foreign Sub-agencies...........	....	1	....	1	....	1	....	1
	3876	775	3716	706	3550	679	3369	671

[107] Supplied by Mr. Henry T. Ross.

Persons per Banking Office. In consequence of the rapidity of branch expansion, the people of Canada have today more banking offices per capita than those of the majority of other countries.

Number of Persons per Banking Office					
Year	Canada	United States	England and Wales	Scotland	Australia
1900	8000	7300	8500	4100	....
1905	5200	5100	7500	4000	....
1910	3250	4000	6800	3800	....
1915	2500	3750	5800	3800	2344
1920	1800	3500	5200	3800	2300 (approximately)
1925	2450	3900	4600	3100	2108

There is a remarkable stability in the number of persons per banking office in Scotland. It seems that the saturation point was reached earlier than in the other countries. In the five-year period from 1920–1925, there has been an increase in banking offices in England, Scotland and Australia, but a decline in Canada and the United States. This would seem to indicate that Canada and certain parts of the United States were overbanked during the period from 1915 to 1920. Whether a nation is or is not overbanked, is of course entirely relative. Nations with scattered populations as Canada and Australia naturally will have more banking offices per capita than England with its dense population. But the fact that since 1920 the number of banking offices has declined would seem to indicate a previously overbanked condition.

Foreign Branches. The foreign branches of the chartered banks have multiplied relatively much more rapidly than the domestic. As the following table indicates, fifteen years ago there were but 52, while now there are 200. In fact, the Canadian banks have more foreign offices than the banks of the United States:

Foreign Branches of Canadian Banks (as of December 31 each year)	
1910	52
1911	70
1912	78
1913	87
1914	93
1915	97
1916	111
1917	120
1918	132
1919	146

	1920	1921	1922	1923	1924	1925
Great Britain	9	9	8	7	7	6
United States	15	15	15	14	13	12
France	3	3	3	3	3	3
Spain	1	1	1	1	1	1
Newfoundland	51	47	37	28	24	25
Mexico	2	2	3	4	6	6
West Indies	102	112	117	123	120	120
Central and So. America	16	16	16	14	14	26
St. Pierre et Miquelon	1	1	1	1	1	1
Total	200	206	201	195	189	200

The rapid establishment of branches in Canada is in part an indication of the flexibility of the Canadian banking system. Wherever the population shifted, to the Prairie Provinces, the gold fields of the Klondike and Cobalt, the ranching or lumbering sections, the banks followed. During the World War branches were established in the concentration camps of the Canadian Army, and followed the troops to Europe. Hamlets with only a few inhabitants have banking accommodation, that would lack such facilities in the United States. In his testimony before the Banking and Commerce Committee in 1913, Sir Edmund Walker outlined the policy of his bank in establishing branches in the West in advance of the railways: [108]

Q. Is this the place where you would like to tell the Committee something about the rules that govern your bank in opening

[108] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 485.

branches throughout the West? — A. In the old days, in Ontario, we waited to open a branch until a community had a population of two or three thousand. We thought it would then pay its expenses in a reasonable period of time. In the West we advanced that condition until we began to go in with the new division of the railway, going in practically with the first storekeeper. At the present time we have, I think, three branches in the Peace River country, miles and miles in advance of the railways. The idea of that is that under our franchises we are expected to serve the part of Canada that is growing so rapidly, and we do not anticipate that these branches will pay at first. Our experience is that on the average they do not pay until the third year. Some of my people say the third or fourth year. It takes six or seven years at least before we have made enough money to cover the losses made in the first three years, so we are really spending out of our profits every year a very large sum of money to establish branches in the western country, which in the nature of things bring us no profits for six or seven years.[109]

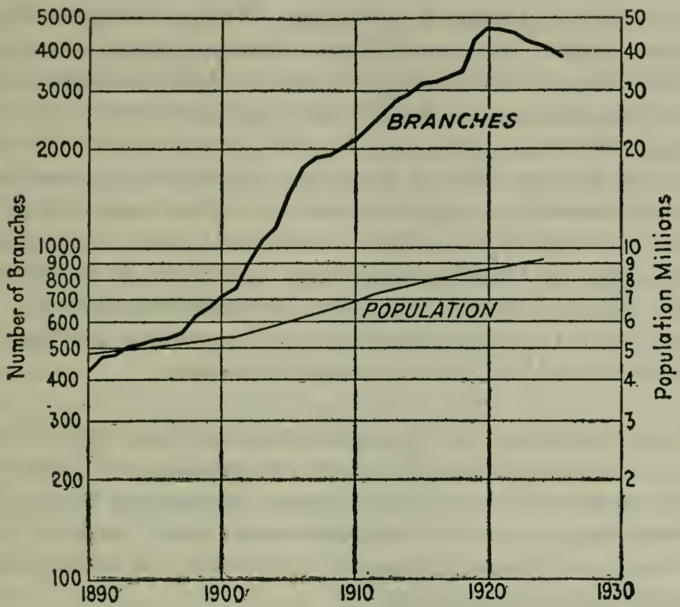
Walker's statement that Canadian banks have more than kept pace with population increases is strikingly illustrated in the ratio chart shown on the opposite page.

Not only are there more banking offices per capita in Canada than in the United States, and not only have banking offices been opened much in advance of population growth, but also it must be noted that the customers have at their disposal, by virtue of the branch system, institutions with millions and hundreds of millions of dollars of assets, with offices in the leading cities of Canada, and in the more important money markets of the world, and in some cases with direct wire service to the commercial centers of the United States. Branches with such power behind them are able to make larger loans, and through their many ramifications are enabled to serve their customers most fully in the selling of foreign and domestic exchange and in obtaining infor-

[109] On this same point see Joseph French Johnson, *The Canadian Banking System,* p. 84, and an article by Eckhardt, entitled " Canadian Banking," in the *Annals of the American Academy for Political and Social Science,* 1913, pp. 161–162, and charts issued by the Department of the Interior, Canada, showing branches of the chartered banks in Manitoba, Saskatchewan and Alberta.

mation relative to business, economic, and credit conditions in Canada and abroad.[110]

CANADA OVERBANKED. The establishment of branch offices has proceeded to such an extent that there has been general agreement during the past ten or fifteen years that Canada has been



THE RATE OF INCREASE IN THE ESTABLISHMENT OF BRANCHES COMPARED WITH RATE OF INCREASE IN GROWTH OF POPULATION

in an overbanked condition. This thought was expressed by Mr. Wilkie, General Manager of the Imperial Bank of Canada, to the members of the National Monetary Commission.[111]

I have just come back from a village in the Northwest and I discovered three banks in a place where there was not business enough for one. At the present moment the branch idea is being carried on to excess.

[110] For a fuller discussion see *A History of the Canadian Bank of Commerce*, Vol. II, by Victor Ross.

[111] *Interviews on the Banking and Currency Systems of Canada*, p. 145.

The same conviction was held by some of the witnesses appearing before the Banking and Commerce Committee in 1923. Thus Mr. George Bevington cited the excessive number of banking offices as responsible for the high rates of interest in the West: [112]

Aside from that I would like to point out another great waste in the system, if I might be permitted. We have a duplication in all of our towns, cities, and villages of banks — I could point you out many places in the west, little towns of 4,000 inhabitants that have from three to five banks operating in the town, with not enough business for one bank, but still they are there. I could point you out one place in particular, where the branches have found it necessary, in order to meet the cost of maintaining the banks, to charge 10 per cent per annum, and to compound it every month; and the branches under those conditions do not show a profit. Take the city of Edmonton, in one block of the city, on either side of the street there are eight tremendous buildings for a city the size of Edmonton, all owned by banks.

Sir John Aird, General Manager of the Canadian Bank of Commerce, admitted that the West was overbanked but explained this on the ground that (a) the Government encouraged the opening of branches as a part of its colonization policy and (b) that branches were opened subsequent to the war as a means of absorbing the returning soldiers: [113]

Q. Just one or two other questions. The witness yesterday stated that the business of the banks in Western Canada was unprofitable. I would like the opinion of the witness as to how far there is a waste in the duplication of services throughout the West which would be responsible for the high cost of carrying on in that portion of Canada. One of the witnesses stated that in a particular town there were quite a number of bank premises on one street, of all of which the rent had to be paid for, or the upkeep expenses on each one; and in his opinion one particular

[112] *Proceedings of the Select Standing Committee in Banking and Commerce,* 1923, pp. 159–160.

[113] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, pp. 358–359. See also speech by Mr. Maclean (Halifax), *House of Commons Debates,* June 19, 1923, p. 4093.

equipment was sufficient to handle all of the banks. Now I want to get at this as to whether or not the duplication of machinery, the multiplication of machinery in Western Canada may not be responsible for the expense of keeping up the service in that part of the country and therefore indirectly responsible for the high interest rates. — A. There are several reasons for that and I would ask the Chairman's permission to digress a little. We, the banks, admit that there are probably too many branch banks in the West but we do not admit altogether that it is the fault of the banks. We were one of the pioneer banks of the West; we were bankers for the Canadian Northern Railway Company at the time — now the Canadian National — and we were requested by the Government in view of the progress of the Dominion to anticipate the extension of that system. We did; we went on from time to time and kept going on even before the railway. As we went on and the country developed as it did from 1898 to 1910 the population increased by probably a million and a half to two million people, and naturally the other banks followed in time and districts were opened up looking forward to the continuance of the development which unfortunately came to an end with the beginning of the Great War. This is, apart altogether from banking, but it will probably answer your question. When the Great War broke out in 1914 there was no class of the community that responded to the call of the Empire as well as did the banks either in men or money. In our case, and I have no doubt it was the case with all the banks but more with our bank — we had a large number of employees in Canada, a larger number than any other bank — nearly forty-five hundred or five thousand, and fifty per cent of the effective force of our staff went to the war inside of the first three months on the understanding that if they were fortunate enough to come back they would be restored to the positions they held before they went to the war and they would get the same salaries they would have got if they had not gone to the war, including increases. Unfortunately for us we lost two hundred or three hundred men and we had a couple of hundred more incapacitated. We had to carry on the bank; what did we do? We took in temporary men and women — a fine lot of men and women too. We had fifteen hundred women. When the war ended we had twelve hundred men come back to our bank and we

had to carry out our obligation and if we had not we could not continue in business. The question was what was the most economical way and most fair way to do. We did not want to open branches, but we opened branches and put these men in Western Canada principally in the new districts. These men got their salaries increased and unfortunately we did duplicate branches, a great mistake in going into the new country, particularly in Northern Alberta and in the Peace River country. No doubt that added to the cost of operating. In addition we could not turn out the fifteen hundred men and women who stood by the bank during the war. We have still some of those on hand. It cost our bank in the last three or four years $1,750,000 to take care of the returned men. We admit we have made mistakes in opening branches and we are trying to rectify that now, but all of the mistakes were not on the part of the banks. It was the insistence of the Government and the people of the West that they should get banking accommodations so we had to open branches in certain points. I think in some of the evidence given yesterday and the day before you spoke about branches being closed and branches being opened. Well, we opened branches. If we closed them it would be an unfair thing to leave a community without the service, and that is why we keep them open.

Though the number of branches established had reached a peak in September, 1921, where there were 4923 in operation, the Dominion Bank as late as 1923 in its annual report expressed the thought that banking facilities were even as yet still in excess of the country's requirements: [114]

The total number of branch banks in Canada has decreased by 221 since a year ago, which is a move in the right direction and a policy which has been advocated by The Dominion Bank for some years past.

Even now, however, it must be recognized that the banking facilities of the country are still far in excess of the requirements of our present population, and while this continues to be the case, expansion into new fields should be limited unless we see a de-

[114] Pp. 24–25.

mand in a particular locality which we think this Bank should serve.

In the past several years we have eliminated certain branches where there seemed little prospect of placing them on a paying basis, and at the present time we do not think there is any branch of this Bank not fully warranted.

Again in its annual report [115] for 1924, the Dominion Bank claimed that the reduction in branches would continue:

The total number of branches operated by the chartered Banks of Canada, which stood at 3,047 at the end of the year 1914, increased steadily throughout the war, reaching 3,446 at the end of 1918. The movement gained impetus after the Armistice and over 1,200 offices were added in the next two years and in October, 1921, the total number of branch banks was 4,717; since when the tendency has been in the opposite direction. At the end of December, 1924, the number had been reduced to 4,028, and there are doubtless many more unproductive branches yet to be eliminated.

It is one of the advantages of a branch banking system, of course, that banking facilities are carried to small villages and remote sections of the country which would not be served by a unit independent type of banking system. When, however, branches of the chartered banks are needlessly duplicated, when branches are established by one institution solely as a checkmate to those of another,[116] the nation becomes saddled with a cost wholly disproportionate to the services rendered. Not that each and every branch of a chartered bank should be placed on a paying basis. Some must be carried by the others in order that all persons may enjoy the fullest banking facilities; just as in the

[115] P. 24.

[116] On this point see testimony of Mr. H. C. McLeod, *Interviews on the Banking and Currency Systems of Canada*, p. 35.

The estimate has been made that in 1920 perhaps half of the branches of the chartered banks were "in the red," were being operated at a loss.

Before the Banking and Commerce Committee of 1913 (p. 215), Mr. G. T. Clarkson, an accountant, testified that the Sovereign Bank and also the Farmers' Bank bled to death, so to speak, from the opening of branch offices.

United States the cost of the rural free delivery must be shouldered by other charges imposed by the Post Office Department. While this service does not pay in a pecuniary sense, it does pay in the sense of serving vital social needs. So in the case of branches located in sparsely settled communities. But where the chartered banks compete in duplicating such branches, the public, as emphasized by Professor D. A. McGibbon in his report on banking conditions in Alberta, may often bear the cost in higher interest rates: [117]

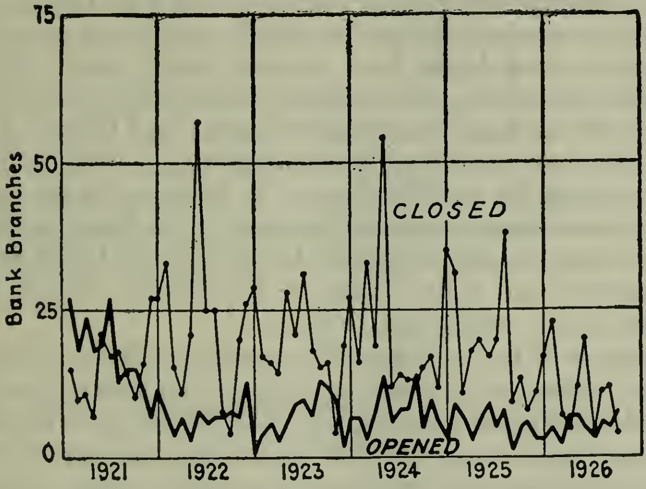
The position of affairs in these two towns in the northwestern part of the Province is as follows: Grande Prairie is the center of a fertile grain and stock district, well built up and comparatively well settled. It is at present the terminus of the railway into the Grande Prairie district. There are five banks in the town of Grande Prairie. Peace River Crossing, one hundred and fifty miles distant, is the gateway into another large and well settled district and has been until recently the terminus of the other branch of the E. D. and B. C. Railway. There is also considerable trade at this point arising from trapping, oil prospecting and river trade. Peace River Crossing has branches of three banks.

There was evidence presented to show that there are branches of more banks established at these points than the volume of business would warrant. If the cost of living is higher than at other points in the Province it is not manifest to the visitor. Yet the prevalent rate of interest is ten per cent. This is defended on the ground of the higher cost of doing business. When a center is so attractive as to induce a number of banks to establish branches there, I see no reason why the rate of interest should be distinctly out of line with other towns in the Province. The latest banks to establish branches at these points cannot plead particular enterprise in going in to serve a new district, nor can they plead that the banks with branches already established there are not able to provide sufficient accommodation. They can put forward no claim to special consideration for charging an especially high rate of interest. The presumption is by increasing the competition there is better or cheaper service to clients. But the only real competition at these points open to them to offer is a reduction in the cost of loans. This has not occurred. Apparently the only

[117] Pp. 15–16.

competition at present at Grande Prairie and Peace River Crossing is a competition that increases the overhead cost of the individual branches and divides the profits of business, done at a high cost, to the public. Substantially the public at these two points are paying a monopoly price for the services of the banks. There probably is no formal agreement between the banks to maintain a ten per cent rate, but their policy has worked out that way. I consider these towns have a legitimate grievance.

The chartered banks within recent years, fully aware of the problem, have been reducing the number of their offices, in part by closing some directly, and in part by the elimination following a merger of duplicating offices. The number opened and closed each month for the past several years is shown in the following chart:[118]



BRANCHES OPENED AND CLOSED EACH MONTH

This portrays graphically the efforts being made to rectify the overbanked condition of Canada, a costly burden for the people and one growing out of over-optimistic forecasts of a quick and phenomenal development of the West.[119]

[118] Data kindly supplied by *The Monetary Times* (Toronto).

[119] As banks expand in size and branches, problems of supervision are rendered much more difficult. This fact has persuaded Mr. H. C. McLeod,

As a concluding observation to this discussion of the overbanked condition of Canada, the following statement kindly sent the writer by Mr. W. A. Mitchell, an authority on this question, is included as being of considerable value and pertinence:

The question of the establishment of branch banks in Canada is one which it is very difficult to criticize empirically. The same demagogues who try to prove that high interest rates are directly caused by overbanking would be the first to complain of a monopoly if, through an agreement, banks restricted the opening of branches in new territories or allocated certain districts to each other. If one bank had a monopoly of the business in a certain district, how much more would such a situation be reflected in increased interest rates than when four or five banks are competing for business in a particular town. Digressing to speak of interest rates, I am sure that in certain sections of Western Canada rates should be very much higher than 10% in order to compensate for the losses which banks have taken in recent years. After a series of crop failures, it is no isolated experience to see from 35% to 60% of the loans of a branch "frozen" and to have a substantial proportion of loans develop into losses. I think that the rates of from 7% to 10% charged in Western Canada are no more than commensurate with the risks run in doing business in this one-crop section. Professor McGibbon in one breath charges monopolistic rate-fixing, whilst in the next he charges overcompetition in establishing branches.

Undoubtedly the banks guessed wrongly in establishing branches so freely after the Armistice, expecting at that time a substantial flow of immigration from Europe. This did not come to pass in the same degree as expected, and the situation was aggravated by a series of bad crop failures and low prices for wheat. However, at this time there was unreasonable competition among the banks in opening branches, attributable perhaps to jealousies among the executives of the leading institutions, but it must be admitted that these men are endeavoring to operate the banks to the best advantage and are at no pains to accumulate or continue "red

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expressed in his work *The Best System of Banking,* that the most efficient and profitable bank is that with few branches (not to exceed 50) and with moderate resources.

figure" branches. Peace River Crossing and Grande Prairie, particularly the former, tap vast stretches of virgin country into which many settlers have gone and which, I am sure, will be the center of the next great development in the West. If branches are retained there without adequate business at the moment, it is bcause the bank executives have vision enough to see that they will be required within a few years, but I have never noticed that banks endeavor to cover excessive overhead in a particular community, due to duplication of facilities, by increasing interest rates. It is, however, difficult to arrive at a fine adjustment of banking facilities to meet the needs of a country situated as is Canada, which has had in the last twenty years a tremendous growth which undoubtedly will be duplicated within the next decade, and which nevertheless has the prosperity of a large portion of its territory subject to the whims of nature. Possibly the best solution of the difficulty would be to have an impartial board composed of economists, business men and government officials who would have the final decision with regard to the opening or closing of branches, but who would have no power to force the closing of a branch if the bank wished to retain it. This would prevent an unreasoned rush into territories which offer attractive possibilities and yet would assure to certain communities adequate banking facilities which might be refused if in the course of time an actual operating monopoly of banking in Canada were arrived at.

THE NOTE ISSUE PRIVILEGES OF THE CHARTERED BANKS

The elasticity of the Canadian bank note, its ability to meet the seasonal requirements of trade, for moving the products of field and forest, has long been the delight and pride of advocates in the United States of the merits of an asset bank-note currency as opposed to a bond-secured currency of fixed volume as exemplified by those issued under the National Bank Act.[120] The latter

[120] For a rather vivid account of the expansibility of an asset currency, see *Interviews on the Banking and Currency Systems of Canada* (National Monetary Commission), p. 59.

notoriously failed to fulfill the functions expected of a bank note issued as they were on an inelastic base, on Government bonds which obviously do not expand and contract in response to the seasonal, cyclical and secular requirements of commerce. And to this must be added the further factor that the rapid retirement of the Civil War debt gave the bonds a scarcity value that largely destroyed profits in circulation. Unless the incentive of profit be present, whether the circulation be an asset or bond-secured type, the element of elasticity tends to be lost. Only a moderate profit will induce banks to use their circulation privilege and in a banking system such as that possessed by Canada, competition for that moderate profit will bring about a prompt redemption of notes. As a result of very elaborate studies of seasonal variations in the supply of money in the United States, Professor Kemmerer concluded that any elasticity possessed by national bank notes was of a "chewing-gum variety." At another place in this same study [121] he indicates that national bank notes were less elastic than some of the other types of money presumably inelastic.[122] The chart on the opposite page illustrates graphically the sluggishness of the bank note of the United States when compared with the responsive nature of the Canadian note.

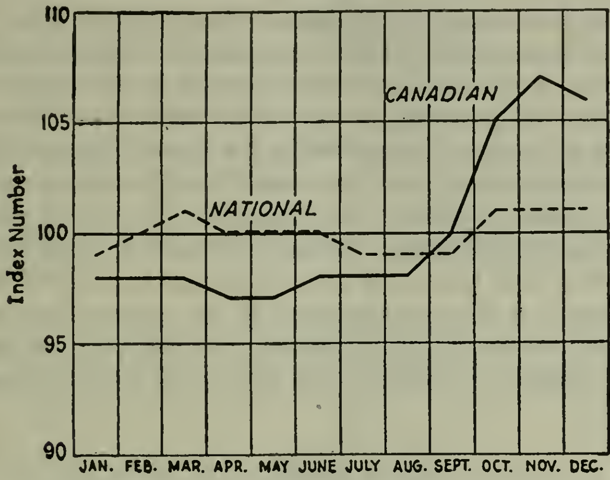
It was this characteristic of the Canadian note which convinced those who would reform the banking system of the United States during the nineties of the desirability of allowing national banks to adopt the same method of note issue. The plan indorsed by the American Bankers Association at a convention held in Baltimore in 1894, the proposals of Secretary of the Treasury J. G. Carlisle, and the elaborate report on contemporary banking and monetary conditions issued by the Indianapolis Monetary Commission, all embodied to a greater or less extent, as the essence of their recommendations, the Canadian method of note issue.

Essence of Canadian Plan. Bank notes in Canada were elastic because they were credit issues, highly profitable and convenient. Each and every chartered bank was then and is now allowed to issue notes to the amount of its paid-up capital which do not have to be secured by any special collateral held in trust,

[121] *Seasonal Variations in the Relative Demand for Money and Capital in the United States,* by E. W. Kemmerer, p. 153.

[122] *Ibid.,* p. 154.

as in the case of the national bank note, but are based simply on the general assets of the issuing bank. Thus they are related directly to commerce, production and agriculture, to the commercial operations of banks rather than to their investment operations or to the fiscal operations and needs of the government. Simple and effective as is this plan, its adoption in the United States was



Seasonal Elasticity of the Canadian Bank Note Contrasted with the Relative Inelasticity of the National Bank Note

blocked by the politicians of the older school [123] who were quite obdurate in their opposition to a "rubber-band" currency, as one was termed which was related to actual business needs.

Origin of Note Issue Privilege. The early banks established in Canada were privileged to issue notes under much the same conditions as were the first and second Banks of the United States whose charters served as the model for these institutions. When the first Dominion Bank Act was enacted in 1871, though some support had developed for the introduction of the bond-secured

[123] The large number of National Banks would have required some modification of the Canadian method of note issue to have given sufficient protection to the note holder. But nevertheless the basic principles of the Canadian plan could have been adopted in the United States and provided this country with an elastic currency.

bank note, these proposals were defeated. For as was explained in 1923 by the Hon. A. K. Maclean of Halifax, Chairman of the House of Commons Committee on Banking and Commerce, it was realized that the asset note was all-important in reducing the cost of opening and operating branches and in giving the nation better banking accommodations: [124]

> I think that originally the right of note issue was given to the banks for good reasons. In the early days in Canada it was desirable that bank branches should be opened in the interest of the development of the whole country. If a bank's capital had to be invested in bonds, as is required in the United States, and they had the right of note issue, they could hardly open up agencies. And the capital was not in this country at that time to carry on business in any other way. There is no doubt in the world that the right of note issue is of some advantage to a bank. At the same time it is of some advantage to the country, because our Canadian banks could not otherwise have had anything like the present number of agencies that they have opened throughout Canada.

There is no doubt that a generation or more ago the asset note currency played a really vital part in furnishing Canada with adequate banking accommodation and so in furthering the economic development of the Dominion. In fact in his testimony in 1913, Sir Edmund Walker declared that "the entire western bank system rests upon the note privilege: [125]

> . . . It rests also upon the fact that the tills of our western offices are filled with unused notes. For instance all banks, if they had not this privilege of issuing notes against circulation, would have to hold a considerable amount of actual specie in

[124] *House of Commons Debates,* June 19, 1923, p. 4092. Sir Frederick Williams-Taylor has estimated that the cost of putting out circulation and "keeping it alive" was 1.75% of the average amount outstanding. *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 331.

[125] *Minutes of Proceedings, Evidence, etc.,* 1913, p. 525. See also Sir Edmund Walker's testimony before the Banking and Commerce Committee of 1923, p. 528, and Sir Frederick Williams-Taylor's testimony, *ibid.,* pp. 329–330.

these western offices, and if they had to live only from the profit on deposits it would sweep the entire banking business of the West out of existence.

Of course it must be remembered that at this time the banks were fighting for the retention of a profitable privilege and that Sir Edmund's remarks were doubtless colored with self-interest. To the extent that the note privilege increased their profits, the banks could devote those funds to the establishment of branches. But surely the note privilege was not all-important for the Joint Stock Banks of England have been able to open thousands of offices without possessing the right to issue currency on any terms. Mr. C. E. Neill, Vice-President of The Canadian Bankers' Association, made much the same sort of statement as did Sir Edmund Walker before the Committee on Banking and Commerce in 1924: [126]

If we did not have the circulation privileges, we would have to draw Dominion notes; we would have to pay real money [as do the British Joint Stock Banks] and we would have to carry the small branches on real money instead of notes, and to that extent the small branches would become unprofitable.

By way of summary, then, the fact that the Canadian banks have been allowed to issue an asset currency, against which they are required to hold no fixed minimum reserve, has been a factor, but over-emphasized by the banks, in permitting an expansion of branches in communities where, without this privilege, it might have been impossible to maintain a branch.

Basic Provisions of Act Regarding Bank Note Issues. Up to the amount of its unimpaired paid-up capital, each chartered bank (subject to a tax of 1% a year) is permitted to issue bank notes in denominations of $5 and multiples thereof. These, as has been stated previously, are not secured by specially pledged securities, but are based solely on the general assets of the issuing bank on which they constitute a first lien in case of insolvency.

[126] P. 272. As a sidelight, it is interesting to note that while the asset note currency has made possible the multitude of branch offices in Canada, these small offices, by bringing about a prompt redemption of bank notes, have relieved to some extent the seasonal pressure on the currency. See *Interviews on the Banking and Currency Systems of Canada*, p. 186.

Each of the chartered banks must make all necessary arrangements for the circulation of its notes at par in any and every part of Canada and must establish agencies for the redemption and payment of notes wherever the Governor in Council has established branch offices of the Department of Finance for the redemption of Dominion notes and at such other localities as are from time to time designated by the Treasury Board. Each bank must receive its own notes at par at its Canadian branches, whether these are or are not designated places of redemption. In actual practice the notes are usually "redeemed" through the clearing houses.[127]

It is a double-acting force which accounts for the elasticity of the Canadian bank note. Each and every chartered bank desires to circulate its own notes to the maximum extent and at the same time to send to the clearing house for payment such notes of the other banks as may have fallen into its possession. The bank notes will thus remain in circulation at a given price level only so long as there is an actual need, only so long as they are required in facilitating trade and production. Once they are redundant, they will be retired.

The Bank Circulation Redemption Fund. In the event of insolvency, the notes of the failed bank constitute a first lien on the assets of the institution, but, as a means of absolutely protecting the note holder, there was established in 1891 the bank circulation redemption fund. This was placed under the direction of the Treasury Board, which may make all such rules and regulations as it deems expedient respecting,

1. The time, manner, and place of payment of any monies therefrom;
2. The collection of all amounts due the fund;
3. The general management of the fund and accounts to be kept in connection therewith.

This fund is built up in the following fashion. Upon issuing the certificate of authority to a newly incorporated bank to begin

[127] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 572. In his testimony in 1924 Mr. Ross said that all banks operating under the Bank Act were accorded clearing house privileges. *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 327.

business, the Minister of Finance retains, from the monies of this bank in his possession,[128] the sum of $5000 to be held until the next annual adjustment when each bank must remit to the fund a sum equal to 5% of the average amount of its notes in circulation during the previous year, less such amount as is secured by deposits with the central gold reserves. On their contributions to the circulation fund, held solely for the purpose of redeeming the notes of failed banks, the chartered banks receive interest at the rate of 3% per annum.[129] In the event of a failure, the notes of the insolvent bank begin to bear interest immediately at the rate of 5% per annum to such time as may be set for their payment. In case the notes are not paid from the liquidated assets of the bank, within two months from failure, the Minister then makes arrangements for their payment from the redemption fund plus accrued interest. Interest ceases upon and from the date named by the Minister for payment. In case the payments from the fund exceed the amount contributed by the bank suspending, the other banks must, on demand, make good to the fund the amount of the excess, proportionately to the amount each has contributed to the fund, provided that:

(a) each bank shall be called upon for payments not to exceed in any one year 1% of the average amount of its notes in circulation;
(b) such circulation shall be ascertained in such manner as the Minister may decide whose decision is final.

The bank circulation redemption fund has made the Canadian bank note a mutual guarantee by the banks, has given it absolute safety and protected the note holders against loss.

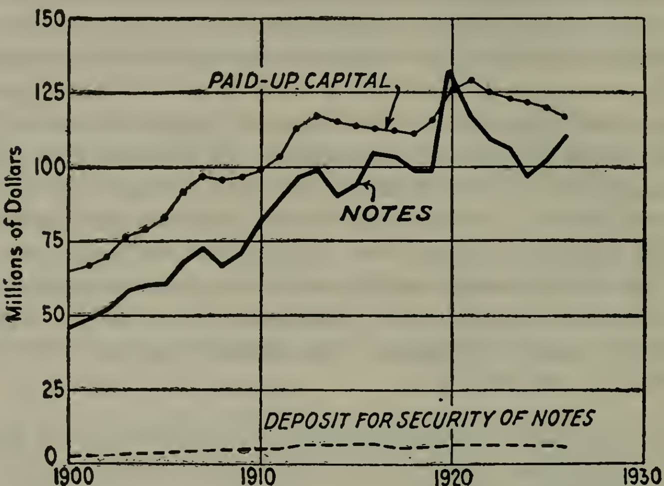
The Crop-Moving Provisions. In the chart on the next page are given the circulation (less deposits of gold and Dominion notes in the central gold reserves) of the chartered banks, their paid-up capital and their deposits with the Minister of Finance as security for the note circulation.[130] It will be noted that the circula-

[128] For explanation of this see p. 347.

[129] The contributions made by the banks go into the Consolidated Revenue Fund, which is used for current expenditures by the Government but on which it has a statutory liability.

[130] Source of data: *Returns of the Chartered Banks.* Data are given as

tion has increased at a faster rate and has gradually crept up on the amount of the bank's paid-up capital. This has left a smaller and smaller amount of slack and made the bank notes less and less elastic, proportionately less capable of expanding to meet the needs of trade and agriculture and indeed less of an asset currency. It was precisely this situation that led to the passage of the act of 1908 providing for additional circulation during the crop-moving



Notes in Circulation (from 1914 less Deposits in Central Gold Reserves), Compared with the Growth of the Paid-up Capital of the Chartered Banks

seasons. Mr. D. R. Wilkie, General Manager of the Imperial Bank, stated to the members of the National Monetary Commission [131] that the authorized limit of circulation was exceeded in 1906 when the amount permitted by law was insufficient to meet the crop-moving demands. In the 1913 hearings, Sir Edmund

of July 31 of each year. Mr. H. C. McLeod indicated in one of his writings that when the circulation of the chartered banks reached an amount equal to 75% of their paid-up capital, the smooth working of the banking system was impaired. From 1900–1907 there was constant pressure. See *The Best System of Banking,* p. 49.

[131] *Interviews on the Banking and Currency Systems of Canada,* p. 140. Mr. Henry T. Ross writes that it was in Nov. 1907 when the authorized limit of circulation was exceeded and not in 1906 as Mr. Wilkie had stated.

Walker further substantiated Mr. Wilkie's contention that to meet the seasonal demands of the West, Dominion notes had been paid out and on occasion money had been imported from the United States.[132] This method of increasing the volume of currency was not always feasible, owing to occasional monetary stringencies in the United States. Again in 1907 there was a shortage of money in the fall [133] which was relieved only through an overissue on the part of the banks. The economic development of the West, the increase in population, the growing importance of the extractive industries, the increasing production of wheat gave rise to the need for an increased circulation,[134] and the paid-up capital was not sufficiently large to permit of an increase of a sufficient size to meet the country's needs. Why then, might one quite fairly inquire, did the banks not increase their capital? The bankers explained that an increase in capital would be difficult.[135] The investment funds in Canada were limited and little demand existed for their stock in England and the United States. Since it seemed difficult to increase the amount of the paid-up capital and to provide for elasticity in this fashion, two courses remained, either (1) to proportion circulation to assets instead of to capital, or (2) to provide for some sort of " emergency " currency which would in part be a negation of the asset currency idea. The former method was supported by Mr. H. C. McLeod,[136] at one time General Manager of the Bank of Nova Scotia, and by a few others, but received no support from the Government. It was the second method which received its favor.

By the provisions of the act, as it stands now, the banks may, from September 1 to February 28, issue additional notes not to exceed 15% of their combined unimpaired paid-up capital and surplus.[137] On the amount of such notes in circulation the banks

[132] *Minutes of Proceedings, Evidence, etc.,* 1913, p. 516.

[133] *Ibid.,* p. 475.

[134] *Ibid.,* p. 640.

[135] *Ibid.,* p. 258.

[136] *Ibid.,* p. 149. See also p. 519 where Sir Edmund Walker indicated that it was more scientific to base notes on assets but that public opinion was not ready for this change.

[137] By the 1908 legislation the emergency currency was to be issued from October to January which period was lengthened from September to February (inclusive) by an amendment passed in 1912. (*The Canada Year Book,* 1925, p. 827.)

are to pay interest to the Minister of Finance at such rate, not to exceed 5% per annum, as may be fixed by the Governor in Council. Thus "emergency" currency was provided, the intent of which was to meet a wholly normal, recurrent, seasonal need. The manner in which this legislation relieved the seasonal pressure was described by Mr. Henderson, vice-President of the Bank of Toronto, in his testimony before the Banking and Commerce Committee in 1913: [138]

The emergency circulation serves a very useful purpose. There are at the present time in our country circumstances that require such an enlargement of circulation for a short period of time as provided for by the emergency circulation. The members will probably all quite understand the reason for that; from September up to the end of November, when the movement of the harvest in the lower provinces as well as the western provinces takes place, there is put out over the counters of the bank every day very large sums of money for the purpose of paying for the amount of grain brought in and delivered at the elevators and warehouses in these places at that time. That money is paid out so that the circulation increases from $20,000,000 to $30,000,000. The banks are permitted to exceed the limits of their circulation upon condition that they redeem it absolutely at the time fixed by the Act. The way that works out is that the circulation goes up day by day, month by month, until it reaches its maximum, about the middle of November, and immediately it commences to return as the money finds its way back as payment on land, implements, the interest on mortgages, the settling of store accounts and things of that kind, and it goes back again to its normal as a rule by the end of the time fixed in the Act. The gold reserve would not meet the necessities of that particular case because we would have to put out actual money in order to increase our circulation by $30,000,000. I think the gold reserve would not so fully meet the requirements of the country as the emergency circulation does at that particular season. But the country is

[138] *Minutes of Proceedings, Evidence, etc.*, 1913, pp. 252–253. In a letter addressed to the writer Mr. B. J. Roberts, Secretary, Department of Finance, Canada, stated that there were no published statistics on the amount of the "emergency" currency issued or on the revenue derived by the Government.

growing, with a yearly increase of over 400,000 in our population, and we will require an additional amount of circulating medium to carry on the business of the country, and it is quite possible we may find our requirements growing a little faster than the Act will allow us to expand our circulation against capital, and for that reason I approve of the proposal.

THE CENTRAL GOLD RESERVES. In the 1913 revision of the Bank Act, a provision was inserted permitting the chartered banks to issue bank notes beyond the amount of their paid-up capital and that allowed by the emergency legislation of 1908, provided that the excess were secured by current gold coin or Dominion notes deposited in the central gold reserves. The gold reserves are administered by a board of four trustees, three appointed by the Bankers' Association, with the approval of the Minister of Finance, and the fourth appointed by the Minister directly.[139]

The establishment of this reserve had long been urged on the Government by the more thoughtful of the Canadian bankers. In his address before the annual meeting of the shareholders of the Bank of Nova Scotia in 1910, Mr. H. C. McLeod indicated that as early as 1902 his institution had advocated the issuance of increased circulation against deposits of gold: [140]

The system of bank note circulation, improved and adopted in 1890, is the notable point of excellence in Canadian banking. If this excellence is to be maintained, the privileges of circulation will need to be enlarged more rapidly than appears feasible through probable additions to bank capital. These privileges are so nearly exhausted that banks freely circulate one another's notes. With the reaching of that point, elasticity, the most admirable feature of the system, ceases to fully exist. Apparently, capitalists are not anxious to invest in bank shares, and it therefore seems to the interest of the country that there should be an

[139] In 1924, the trustees were the Royal Trust Company, the Bank of Montreal, the Canadian Bank of Commerce, and the Royal Bank. The assets are placed in the vaults of the Royal Trust Company, Montreal. *Proceedings of the Select Standing Committee on Banking and Commerce*, 1924, pp. 275, 354, and 355.

[140] *Seventy-Eighth Annual Report*, Bank of Nova Scotia, p. 19. The practice mentioned by Mr. McLeod of the banks paying out each other's notes does not prevail at the present time.

enlargement of the privileges of circulation, either based on a portion of the reserve fund or on the deposit with the Government of gold against notes circulated in excess of the present circulation limits. From the outset, we have opposed the emergency circulation provisions of the Bank Act, as the provisions are of no use to this institution, which has not yet thought it advisable to pay 5% interest for the privilege of note circulation. Eight years ago we sought an amendment to the Bank Act permitting increased circulation against deposits of gold with the Government. A provision of that kind would tend towards an increase of specie in the country and would form the basis of operations by conservative institutions. The emergency circulation has been but little used by any of the banks and in the future it is more likely to be availed of by the needy, to whom the rate of interest is a secondary consideration: it cannot be a stable foundation for note circulation by conservative banks.

Later, in the proceedings before the Banking and Commerce Committee in 1913 the need for this legislation was explained in considerable detail by Sir Edmund Walker: [141]

I have personally advocated among bankers for at least seven or eight years such legislation as this. There are three conditions that face us at the present time in Canada in connection with the circulation, one is the necessity almost every year of issuing up to the entire amount which we are authorized to issue against our paid-up capital. The second is the necessity of using the emergency circulation as a circulation of exactly the same kind as that against the capital, during the period when the crop is being moved. But we have another condition here altogether different from these. It is the condition where the bank is using its full circulation against capital, and is using its emergency privilege, (or does not use it because it does not wish to pay interest to the Government for using it), and requires still more circulation for its customers. It has the money but has not the actual counters to do business with. It has gold but it needs bank notes. In all other countries in the world, if the bank has circulating power such as we have it is not called upon to put out the

[141] *Minutes of Proceedings, Evidence, etc.*, 1913, pp. 515–516.

notes of any other bank or the notes of the Government or any other kind than its own notes, so long as it has actually the specie to secure those notes. We have been in the condition I have described more than once in connection with the moving of grain in the West; we have been in the condition of having the money but not having the actual five- and ten-dollar bills on the counters with which to do the business; we have had to ask the Government to provide the counters and keep this gold for us, to warehouse the gold and to assume all the responsibility and the expense which is certainly a very wrong thing, and the Government will not be satisfied to do it forever. Therefore I conceived the idea of a Central Gold Reserve, the custody of which will be as safe as the Bank of England, and that as long as the bank had in that reserve a five-dollar gold piece it should be able to issue a five-dollar bill against it.

In addition to Sir Edmund Walker, another banker, Mr. Pease, General Manager of the Royal Bank, also emphatically indorsed [142] the proposed change indicating that his institution would be glad to avail itself of the opportunity of depositing gold and taking out additional circulation as it had reached a limit in the matter of circulation. The adoption of this provision marked a most important change in the Canadian note issue. While originally it had been related to bank assets, it was now, in part at least, tied to gold. No longer could it be called a pure bank-note-asset currency.

The table on page 388 indicates the extent to which the Canadian banks availed themselves of the central gold reserve provisions prior to the outbreak of the war.[143] The increase in the deposits between September and October of 1913 is reflective of the rôle played by seasonal forces which apparently had spent themselves by the first of the year. From July, 1914, on the amount deposited was governed almost wholly by considerations of war finance.

THE FINANCE ACT. The events leading to the passage of the Finance Act in Canada are graphically described by Sir

[142] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 537. See also p. 321 where Mr. James B. Forgan, President of the First National Bank, Chicago, gave his reasons for supporting the change.

[143] Source: *Returns of the Chartered Banks.*

Date	Deposits in Central Gold Reserves
1913, July 31,	$ 0
August 30,	0
September 30,	3,350,000
October 31,	7,373,977
November 29,	8,100,000
December 31,	7,597,066
1914, January 31,	3,500,000
Feburary 28,	3,000,000
March 31,	3,500,000
April 30,	3,250,000
May 30,	3,550,000
June 30,	3,050,000

Thomas White, who was the Minister of Finance during the hectic days following the outbreak of the World War, in a work entitled "The Story of Canada's War Finance."[144] As he describes the situation, the closing of the stock exchanges and the crises which developed in Europe and the United States during the latter part of July, 1914, induced a general feeling of uneasiness, of apprehension, a panicky psychology in the Dominion. Heavy withdrawals of gold took place in Toronto and Montreal and it seemed not at all improbable that these might develop into runs upon the banks. The situation became so critical that on Monday, August 3, the leading members of The Canadian Bankers' Association, headed by its President, Mr. D. R. Wilkie, arrived in Ottawa to confer with Sir Thomas White regarding remedial measures. It was recognized that the cash reserves of the banks were insufficient to meet the drain and that their other reserves in the form of call loans in New York and London were not available. To prevent insolvencies occasioned by the inability of the banks to withstand withdrawals in Dominion notes or gold, it was agreed that they should be allowed to meet their depositors' demands with their own notes. The bank notes were in reality given the legal tender power as between a bank and its creditors though not as between individuals. In order to insure that the banks would have sufficient bank notes, it was provided:

[144] Published by the Canadian Bank of Commerce, 1921. Mr. Pease of the Royal Bank had long been a proponent of a central bank to meet such a situation. His plan was opposed by the Bank of Montreal and the other chartered banks were lukewarm.

(1) that the emergency circulation might be issued the entire year instead of simply during the crop-moving period. This provision lapsed on August 31, 1920, and was not renewed.

(2) that the Government would issue Dominion notes (charging interest on such advances) to the banks against deposits of securities pledged with the Department of Finance. The intent of this was to permit the chartered banks to secure additional amounts of Dominion notes which could then be placed with the central gold reserves and used as the basis for an increased bank note circulation.

These proposals or measures were embodied in an Order-in-Council of August 3, signed by the Governor-General, and issued to the public on the morning of the day England declared war on Germany. A week later (August 10) another Order-in-Council suspended the redemption in specie of Dominion notes. These had the desired effect of providing sufficient currency to meet the needs of the public and of protecting the gold reserves of the Dominion and of checking the panic. At the August session of Parliament, the Orders-in-Council were legalized through the passage of the Finance Act.[145]

In order to provide for the increased issues of Dominion notes, by chapter 4, acts of 1914, it was provided that the amount to be issued upon a 25% gold reserve was to be increased from 30 to 50 millions of dollars. Still later, by chapter 4, acts of 1915 (confirming Orders-in-Council of September, 1914) the Government was authorized to make an extra issue of Dominion notes up to $26,000,000 with no reserve of gold. Of these $16,000,000 were to be secured by the pledge of specified Canadian railway securities, guaranteed by the Government. This legislation still continues as well as the provision of the Finance Act (1914) that in case of war, panic, etc., Dominion notes may be issued to any amount against approved securities.

THE TREASURY BOARD. The Finance Act is administered by

[145] For a full discussion of Canada's monetary and banking experience during and since the war, see the *Federal Reserve Bulletin* for July, 1926, pp. 534–537. This article served largely as the basis for the present discussion.

the Treasury Board which consists of the Minister of Finance, five members of His Majesty's Privy Council (appointed by the Governor-General) with the Deputy Minister of Finance as Secretary, ex-officio.[146] This group determines the kind and amount of securities to be accepted for advances within the limitations of section 2 of the 1923 supplement to the Finance Act of 1914. The securities or paper made eligible by law are: [147]

(a) treasury bills, bonds, debentures, or stocks of the Dominion of Canada, United Kingdom, any province of Canada, and of any British possession;
(b) public securities of the Government of the United States;
(c) Canadian municipal securities;
(d) promissory notes and bills of exchange secured by documentary title to wheat, oats, rye, barley, corn, buckwheat, flax, or other commodity;
(e) promissory notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes and which have been used or are to be used for such purposes.

Maturity of Advances. Advances on the basis of securities are made for a period not to exceed one year, while all pledged promissory notes or bills of exchange must mature within a period of six months. No advances may be made on paper which originated for the purpose of carrying or trading in securities or for capital expenditures.[148] These prohibitions resemble closely those to be found in the Federal Reserve Act and in fact in the charter of nearly every central bank.

Margin Requirements. As explained by Mr. Saunders before the Banking and Commerce Committee of 1924,[149] advances are extended to various proportions of the value of the pledged securities. Under the provisions of Section 12 of the Act a

[146] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, pp. 344 and 347. The weakness of a board chosen in this fashion is that it is likely to be composed of men untrained in the judgment of securities or bankable paper.

[147] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 343. *Select Standing Committee on Banking and Commerce,* 1928, p. 1.

[148] *Federal Reserve Bulletin,* July, 1926, p. 535.

[149] See pp. 344–345.

Treasury Board Minute of May 30, 1923, authorized the margins by which the different classes of securities deposited should exceed in value the amount of the loans. The schedule is as follows:

Against Dominion of Canada Treasury Bills and Bonds — advances to be made dollar for dollar of the par value;

Against bonds guaranteed as to principal and interest by the Government of the Dominion of Canada — a margin of 10 per cent on the market value;

Against British Government Treasury Bills and Bonds — a margin of 10 per cent on the market value;

Against short-term securities, not exceeding one year, of the Governments of the Provinces of Canada — a margin of 10 per cent on the market value;

Against other securities of the Provinces of Canada and securities carrying the guarantee, as to principal and interest, of the provinces of Canada — margin of 15 per cent on the market value;

Against bonds of Canadian municipalities — a margin of 20 per cent on the market value;

Against assignments secured by documents — covering grain, flour, cereals and feed — a margin of 25 per cent;

* * *

Rates of Interest Charged. From 1914 to November 1, 1924, with one exception, the rate charged on advances ruled continuously at 5% at which time it was reduced to 4¼%. This exception occurred in 1916 when the banks purchased certificates bearing 3½% interest from the Imperial Treasury and were allowed to borrow on these from the Dominion at the same rate. The total so borrowed amounted to $56,457,000. This particular arrangement was not repeated as the banks, so Mr. Saunders declared, were "afraid of it,"[150] meaning perhaps that they were afraid of the inflationary effects. On November 1, 1927, the rate was reduced to 4% and a month later, on December 1, to 3¾%. On June 8, 1928, the rate was raised to 5%.

Manipulation of the Interest Rate. There is no suggestion

[150] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 348. For further discussions see *ibid.,* 1923, p. 132.

in the Finance Act that the rates charged by the Treasury Board should be altered with a view of affecting the business situation, of preventing inflation or deflation, of ironing out cyclical sweeps in business, of preventing or checking speculation, or of performing the functions expected of the rate of discount of a central bank. Nor has the Treasury Board in its administration of the Act considered changes in the interest rate in the light of stabilizing conditions. In testifying in 1924, Mr. George Edwards, chartered accountant, stated quite definitely that the rate charged was not changed to check inflation or deflation, or for the purpose of stabilizing economic conditions.[151] As noted in the previous paragraph the rate ruled at 5% until in November of 1924. The lack of change during this period when interest rates through the world soared skyward, when the discount rate at the Federal Reserve Bank of New York ruled at 7% for nearly a year, is sufficient evidence in itself that the Treasury Board did not look upon the rate as a central bank would upon its rate of discount. That this was not the case was an error in administration. The rate should have fluctuated with economic and financial conditions.[152] Other-

[151] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 46. See also pp. 349 and 375.

[152] In reading this paragraph, Mr. Henry T. Ross, Secretary of The Canadian Bankers' Association, took exception to this statement and defended the non-fluctuating rediscount rate in the following terms:

"After the war had been in progress for some time, probably early in 1915, Sir Thomas White, anxious in the public interest to keep financial matters as much as possible in *statu quo,* having in mind the rate on loans which he foresaw he would have to ask the Canadian public to subscribe, requested the banks not to increase the interest rate to their customers. While there was no distinct promise, the implication was that the rate under the War Finance Act of 5% would not be raised by the Treasury Board of which Sir Thomas was the Chairman. In consequence the banks did not raise their rates during the continuance of the war — something without parallel among the Allied nations — to the advantage of the whole country, and the 5% rate under The Finance Act remained constant too. Instead, therefore, of being a matter of criticism, such as the paragraph implies, the foresight of Sir Thomas White in this particular, and the relative action by the banks, should in my judgment be commended."

The same error was made in the United States, where under the influence of the Treasury Department, the rediscount rates at the Reserve Banks were held to artificially low levels so as not to exceed the interest borne by the war bonds. This enabled banks buying or lending on war bonds to borrow on these at the same rate borne by the bonds from the Reserve Banks. This policy contributed much to war inflation in the United States.

wise a low rate, lower than market rates of interest and especially lower than the call loan rate in New York would be an inducement towards inflation. When the question was put to Sir Edmund Walker whether inflation would not continue under the Finance Act, he replied as follows: [153]

Q. Yesterday, Sir Edmund, speaking of the reserve bank, you stated that it had been considered in the States a means of inflation? — A. Yes.

Q. What difference is there between the operations of a Federal Reserve Bank and the issue of notes under the Finance Act? What difference is there in principle? — A. There is no difference in principle.

Q. Then why would not inflation continue under the Finance Act? — A. In the United States there are 26 or 27 thousand banks and each one of them is an individual, and if a member of the Federal Reserve Bank, must apply to it for its particular needs. In Canada, with 17 banks, an enormous amount of the rediscounting that would take place in the United States has been managed within the bank itself. The instances of a Canadian bank needing aid from the Finance Act have not only been relatively rare, but they have been confined to the actual moving of the crops and have been paid off during the year. Now in the United States a vast amount of rediscounts appear in the Federal Reserve system which go on, they are not stagnant, but they go on from year to year, and I mentioned, if you will remember, that they had to finance the war and that they loaned on an enormous amount of Government bonds in that connection. If you will take a small bank in the country with a capital which enables it to lend two or three hundred thousand dollars, and you enable that bank to go to the Federal Reserve Bank and get one or two or three hundred thousand more.

Q. They have to put up security, don't they? — A. Certainly.

Q. And rather strong security? — A. No, no, not at all like the security we put up with the Finance Department at Ottawa, no relation at all. Their system enables them to finance many undertakings which could not otherwise have been financed at all,

[153] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 534.

and that is what I mean by inflation. It is a question of proportions entirely.

In reading this testimony one is puzzled by Sir Edmund's assertion that the instances of Canadian banks needing aid have been few and confined to seasonal needs. While it is true that their largest borrowings have often occurred in the fall, some of the Canadian banks, nevertheless, have been fairly constant borrowers and were such particularly during the war in order to assist meeting the fiscal needs of the Government.

Advances Under the Finance Act. The first return of the chartered banks containing any information relative to the amount of advances under the Finance Act was that of October 31, 1923, the first issued in conformity with section 112, of the Bank Act of 1923. The amount of the advances extended to each of the chartered banks to November, 1927, are given in the table on pages 395 and 396.[154]

From this table it will be noted that the Bank of Montreal, the Bank of Nova Scotia, the Imperial Bank, and the Weyburn Security Bank, at least since the data have been made public, have not borrowed under the provisions of the Finance Act. Of the borrowing banks Molson's, the Banque Nationale, the Union, the Bank of Hamilton, the Sterling Bank and the Standard have all been absorbed by or merged with other institutions. Of the banks still in existence, the Dominion and Royal have been the most consistent borrowers. The borrowings of the Bank of Toronto and of the Canadian Bank of Commerce have been more intermittent and were occasioned doubtless to some extent by seasonal requirements. During the period covered by this table, the Royal Bank has borrowed, in all, 235 millions of dollars, the Dominion 126.1 millions and the Standard Bank 123 millions. The largest borrowed during any one month by all the banks amounted to 37.8 millions of dollars during April, 1924. In the monthly aggregate figures there is apparently little noticeable seasonal fluctuation, but this may emerge as data for a longer period become available.

[154] Source of data: *Returns of the Chartered Banks.*

ADVANCES UNDER THE FINANCE ACT (1914)

(000 omitted)

Date (Last banking day of each month)	Banque Canadienne Nationale	Bank of Toronto	Molson's Bank	Banque Nationale	Union Bank of Canada	Canadian Bank of Commerce	Royal Bank of Canada	Dominion Bank	Bank of Hamilton	Standard Bank	Banque d'Hochelaga	Sterling Bank of Canada	Total for All Banks
1923													
July	......	......	......	......	....	....	....	......	......	......	......	......	....
Aug.	......	......	......	......	....	....	....	......	......	......	......	......	....
Sept.	......	......	......	......	....	....	....	......	......	......	......	......	....
Oct.	......	......	$1,000	......	$12,500	....	....	$2,800	$3,250	$3,000	......	$3,800	$26,350
Nov.	......	......	......	$ 400	8,100	$8,000	....	2,800	1,000	4,000	......	4,200	28,500
Dec.	......	$2,500	......	2,000	7,500	4,500	....	4,000	2,500	3,000	$1,000	4,200	31,200
1924													
Jan.	......	......	......	1,990	8,500	6,000	....	1,500	......	2,000	500	4,200	24,690
Feb.	......	2,000	......	1,972	9,500	....	....	4,500	......	......	......	3,900	21,872
Mr.	......	2,000	2,000	1,328	8,000	....	....	4,500	......	1,500	......	3,700	23,028
Apr.	......	2,000	2,000	......	9,000	7,000	$5,000	3,500	......	2,000	4,000	3,300	37,800
May	......	......	2,000	......	3,000	3,500	5,000	1,500	......	2,500	4,000	3,800	25,300
June	......	......	1,000	......	1,000	5,500	2,000	2,800	......	2,000	2,000	2,900	19,200
July	......	900	1,000	......	6,500	....	2,000	2,700	......	2,500	1,500	2,600	19,700
Aug.	......	100	1,000	......	7,000	....	5,000	4,000	......	3,200	......	2,400	22,700
Sept.	......	......	......	......	6,500	....	5,000	2,000	......	3,000	......	2,900	19,400
Oct.	......	2,100	......	......	....	10,000	5,000	2,500	......	2,500	......	2,100	24,200
Nov.	......	......	......	......	....	6,000	....	3,000	......	1,500	......	2,200	12,700
Dec.	......	300	......	......	....	8,000	12,000	4,300	......	3,000	......	2,800	30,400
1925													
Jan.	......	......	......	......	....	8,500	3,000	4,800	......	2,300	......	......	18,600
Feb.	......	4,500	......	......	2,400	....	9,000	4,700	......	700	......	......	21,300
Mr.	$1.000	2,900	......	......	....	2,000	5,000	800	......	3,000	......	......	14,700
Apr.	1,500	1,000	......	......	1,000	....	8,000	1,800	......	4,300	......	......	17,600
May	1,500	......	......	......	....	....	10,000	2,800	......	2,300	......	......	16,600
June	3,000	......	......	......	1,000	....	12,000	600	......	3,200	......	......	19,800
July	......	......	......	......	3,250	....	12,000	2,500	......	2,500	......	......	20,250

ADVANCES UNDER THE FINANCE ACT (1914) — *Continued*

(000 omitted)

Date (Last banking day of each month)	Banque Canadienne Nationale	Bank of Toronto	Molson's Bank	Banque Nationale	Union Bank of Canada	Canadian Bank of Commerce	Royal Bank of Canada	Dominion Bank	Bank of Hamilton	Standard Bank	Banque d' Hochelaga	Sterling Bank of Canada	Banque Provinciale du Canada	Total for All Banks
Aug.	$ 500	......	......	......	......	......	$14,000	$2,000	......	$3,700	......	......	......	$20,200
Sept.	......	......	......	......	......	$1,000	7,000	1,000	......	2,200	......	......	......	11,200
Oct.	......	$1,900	......	......	......	......	10,000	2,000	......	1,750	......	......	......	15,650
Nov.	......	......	......	......	......	......	......	2,500	......	4,500	......	......	......	7,000
Dec.	......	......	......	......	......	......	14,000	......	......	750	......	......	......	14,750
1926														
Jan.	......	......	......	......	......	......	8,000	1,000	......	......	......	......	......	9,000
Feb.	......	......	......	......	......	......	......	1,000	......	1,000	......	......	......	2,000
Mr.	......	1,000	......	......	......	......	6,000	1,500	......	1,500	......	......	......	10,000
Apr.	......	4,500	......	......	......	7,000	......	6,500	......	3,000	......	......	......	21,000
May	......	600	......	......	......	10,000	......	2,700	......	2,500	......	......	......	15,800
June	5,500	......	......	......	......	8,000	......	3,300	......	3,000	......	......	......	19,800
July	6,000	......	......	......	......	3,500	......	3,500	......	3,000	......	......	......	16,000
Aug.	2,000	......	......	......	......	3,000	2,000	4,000	......	3,300	......	......	......	14,300
Sept.	......	......	......	......	......	3,000	10,000	3,500	......	2,300	......	......	......	18,800
Oct.	......	......	......	......	......	7,000	10,000	4,800	......	3,000	......	......	......	24,800
Nov.	......	1,500	......	......	......	5,000	......	3,400	......	3,250	......	......	......	13,150
Dec.	......	......	......	......	......	......	10,000	......	......	1,500	......	......	......	11,150
1927														
Jan.	......	......	......	......	......	......	10,000	......	......	......	......	......	......	10,000
Feb.	......	1,000	......	......	......	5,000	10,000	......	......	500	......	......	......	16,500
Mr.	......	1,500	......	......	......	8,000	......	1,000	......	2,000	......	......	......	12,500
Apr.	......	3,500	......	......	......	11,000	......	1,000	......	4,500	......	......	$ 800	20,800
May	2,500	2,000	......	......	......	......	......	500	......	2,250	......	......	1,450	8,700
June	9,500	......	......	......	......	......	......	2,000	......	3,000	......	......	1,450	15,950
July	10,000	1,000	......	......	......	1,000	......	2,000	......	2,000	......	......	1,050	17,050
Aug.	8,500	......	......	......	......	5,000	5,000	2,500	......	3,500	......	......	1,450	25,950
Sept.	7,000	......	......	......	......	3,000	7,000	1,500	......	3,000	......	......	1,250	22,750
Oct.	2,000	1,000	......	......	......	6,000	12,000	4,000	......	4,500	......	......	1,250	30,750
Nov.	......	......	......	......	......	9,000	......	4,500	......	3,500	......	......	......	17,000

For data regarding the amount of advances prior to October, 1923, we are forced to rely on the figures presented by Mr. Saunders in his testimony before the Banking and Commerce Committee in 1924. There are no others published excepting those to be found in the *Public Accounts* which give the advances as at the end of each fiscal year, on March 31. These are of less significance than the statistics presented by Mr. Saunders,[155] which give the maximum amount of advances during the year, which quite frequently occurred during the crop moving period.

Month	Maximum amount of advances in each year
November, 1914	$ 12,767,500.00
January, 1915	10,720,000.00
February, 1916	2,777,135.00
October, 1917	52,170,000.00
November, 1918	116,500,000.00
November, 1919	112,957,000.00
November, 1920	123,689,025.00
January, 1921	108,707,960.75
January, 1922	60,619,769.74
October, 1923	40,020,000.00

The largest amount of advances took place in November, 1920, the reason for which was explained by Mr. Saunders as follows: [156]

Q. You mentioned that the Finance Act was being used a great deal a few years ago, and today it was being used little, comparatively speaking? — A. Yes.

Q. Can you tell me when it is used more, when the country is prosperous, or when we have adverse conditions? — A. It would be used more when the country is prosperous. In November, 1920, as I told you this morning, that was the peak of all the years. The banks had loans under the Finance Act amounting to $123,000,000. If you will recall, Mr. Spencer, in 1920 everything was booming; it was after the war and there was inflation

[155] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 346.
[156] *Ibid.,* p. 376.

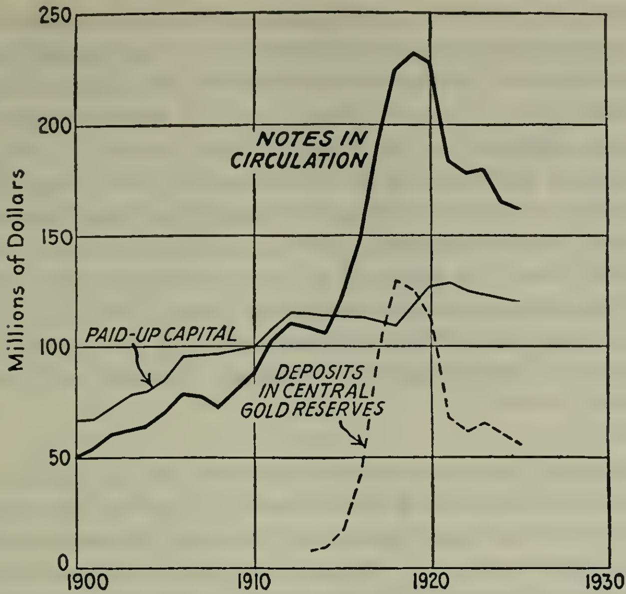
in prices and business was booming a little, which naturally required more money. The dollar was worth less, and it required more dollars to carry on business.

Q. That was my opinion. Then, Mr. Saunders, you would say that the banks find it profitable to borrow through the Finance Act? — A. I think they find it more useful in being able to meet business that is offered to them, when their own resources would not permit. They cannot find it very profitable, because they are so eager to get it back into our hands to save the five per cent interest rate.

Purpose of Advances. In answer to a series of questions Mr. Saunders indicated that the banks usually borrowed to meet adverse clearing house balances. For this purpose they would withdraw their borrowings in large Dominion notes, " large legals," and would repay as quickly as circumstances would permit.[157] Of course the banks receiving the large legals through the clearing houses or the banks borrowing would be entitled to deposit these in the central gold reserves and issue an equivalent amount of their own bank notes. That this has been the case is demonstrated in the chart on the opposite page which compares the note circulation of the chartered banks with their paid-up capital and deposits in the central gold reserves. The evolution of the Canadian bank note has been quite far-reaching. Originally it was a true asset currency, particularly in the nineties, very elastic and responsive to trade and business need. Then as the year-to-year growth of the notes crept up on the amount of the paid-up capital, their elasticity became impaired and the law of 1908 permitting an emergency circulation was the result. In 1913 their issue against deposits of gold and Dominion notes was permitted and a year later issues of Dominion notes were permitted against certain acceptable securities. It was on the basis of the increased issues of Dominion notes based on securities that the war expansion in the bank notes occurred.

Amount of Interest Paid to Government. In another part of his testimony Mr. Saunders declared that the Dominion Gov-

[157] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1924, p. 349. See also statement by Mr. Ross, *ibid.*, p. 321, and by Mr. C. E. Neill, p. 282.



THE NOTES OF THE CHARTERED BANKS IN RECENT YEARS HAVE BEEN BASED TO A LARGE EXTENT ON DEPOSITS IN THE CENTRAL GOLD RESERVES

ernment had not lost a penny in these advances and that its interest return in dollars had been as follows: [158]

Year ended March 31st	Amount
1915	$ 211,551.97
1916	62,722.49
1917	105,458.12
1918	754,792.01
19 9	2,395,643.02
·1920	3,322,952.78
1921	3,568,106.74
1922	2,392,598.57
1923	1,249,677.90
1924	775,170.38
Total	$14,838,673.98

[158] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, pp. 346 and 354. For details of administration, see *ibid.,* p. 344.

The Finance Act provided Canada with rather a rudimentary but nevertheless simple and convenient and inexpensive central bank mechanism. It provided a means for the banks to enlarge their holdings of "legals" which could be used to meet clearing house balances or to increase their own note issues, an arrangement which was of the utmost importance during the war in enabling the banks to expand to meet fiscal requirements. It has made a close relationship between the Government issues, the Dominion notes, on whose issue there are practically no legal limits, and the bank note circulation. Even since the war it has proved useful, as Sir John Aird indicated, and will probably continue as an integral part of Canada's financial and banking machinery: [159]

> Introduced as a war measure because of the disorganization of the foreign exchanges during the Great War, and of the obstacles thus raised to the usual methods of financing the requirements of the Canadian banks, . . . the Act has proved a measure of no small value in meeting the fluctuating seasonal requirements of Canada's trade. As the figures of the balance sheet show, we avail ourselves of its facilities, and it is our intention to continue to do so from time to time for the purpose of providing for the peak load of marketing the natural products of Canada . . .

It was this Act, this arrangement, that permitted the war inflation, that allowed for the issuance of greater amounts of currency and, upon this as a base, for the creation of an inflated superstructure of credit. The mechanism was used, as indeed were the Federal Reserve Banks in the United States, as a means of securing men and supplies on the basis of "manufactured" purchasing power. As a second result, it has had the effect of taking in part the responsibility for the maintenance of the cash reserves of the nation from the chartered banks. Enacted by virtue of the war emergency, the Finance Act has been continued as a sort of rediscounting or central bank machinery. At the present time, it is probably all that Canada needs by way of a central bank. If used by the banks, not continuously, but simply as a means

[159] Address of Sir John Aird, General Manager, in *Annual Report of The Canadian Bank of Commerce,* Nov. 30, 1923, p. 30.

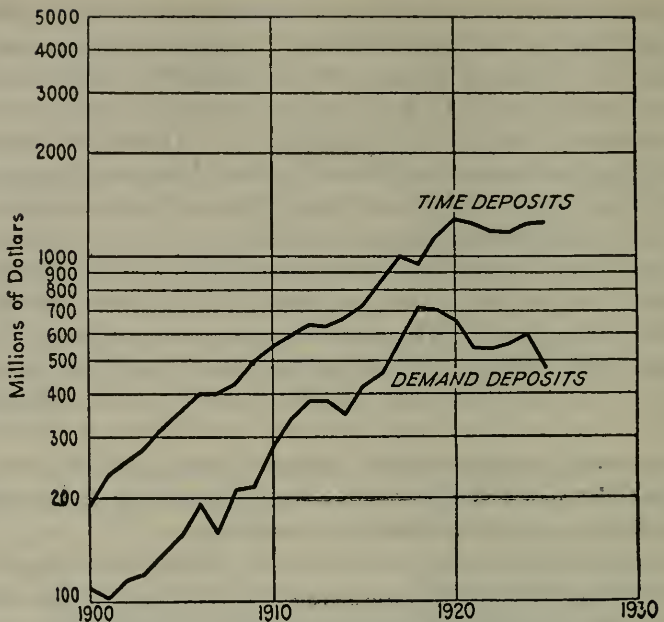
of financing seasonal requirements, its introduction will probably be beneficial. The administration of the Act, however, on the part of the Treasury Board could be improved. First, the rate for advances should be held above the market and especially above the call loan rate in New York City. Otherwise, the chartered banks in case of need would borrow from the Government rather than to call in their call loans. Then in the second place, the returns of the chartered banks should give not only the amount of the advances outstanding on the last day of the month, as at present, but also the maximum amount of advances during the course of the month. The present arrangement induces a bank, which might dislike to be recorded as borrowing from the Government, to pay off its loans shortly before the end of the month and so " window-dress " its statement. And finally, the Treasury Board should inquire carefully into the reasons for the loans and refuse those which would permit a bank to continue to participate in and give support to speculative markets.

Deposits — Demand and Time. By Section 95 of the Bank Act, the chartered banks are given wide latitude in the matter of accepting deposits, for they may receive these from any person whomsoever, whatever his age, status or condition in life, and whether such person is qualified by law to enter into ordinary contracts or not.[160] In the returns of the chartered banks, deposits are divided into eight classes which gives us rather detailed information regarding this phase of Canadian banking. Commercial institutions though they be, it is interesting to note that their savings deposits, or more exactly those payable after notice or on a fixed day, are at present 2½ times as large as deposits payable on demand. The growth of time and demand deposits in Canada since 1900 is represented in the graph shown at the top of the next page.[161] Up to 1918 demand deposits were increasing at a slightly faster rate. Subsequently demand deposits, in consequence of the price deflation and the business depression, have fallen by about 200 million dollars, while time deposits have actually increased.

The time or savings accounts are, according to the rules estab-

[160] In the Province of Quebec a married woman is under considerable handicap as a bank depositor.

[161] Source of data: *Returns of the Chartered Banks.* Ratio Scale.



Comparison of Rate of Growth of the Time and Demand Deposits of the Chartered Banks

lished by each bank, usually subject to a withdrawal notice of fifteen days. Ordinarily this right is not exercised by the bank, and in practice they are similar to demand deposits in that they are checked against rather freely. Interest on these slow checking or savings accounts is allowed at the rate of 3% per annum on the minimum monthly balance at all of the chartered banks excepting at the Weyburn Security Bank, where the rate is 4%.[162]

The law does not require a segregation of savings accounts or provide for their investment in any prescribed fashion. They are used customarily to build up the loanable and investment pool of the banks and are utilized in the same fashion as the strictly de-

162 In his testimony in 1913, Mr. D. R. Wilkie indicated that there was an "understanding" among the banks regarding the 3% rate but that there was nothing to prevent a bank from paying more and that no penalties could be imposed for any deviations. *Minutes of Proceedings, Evidence, etc.*, 1913, p. 654. Some of the banks deviate from the 3% rate in the case of employees, municipal corporations and pension funds. *Interviews on the Banking and Currency Systems of Canada*, p. 88.

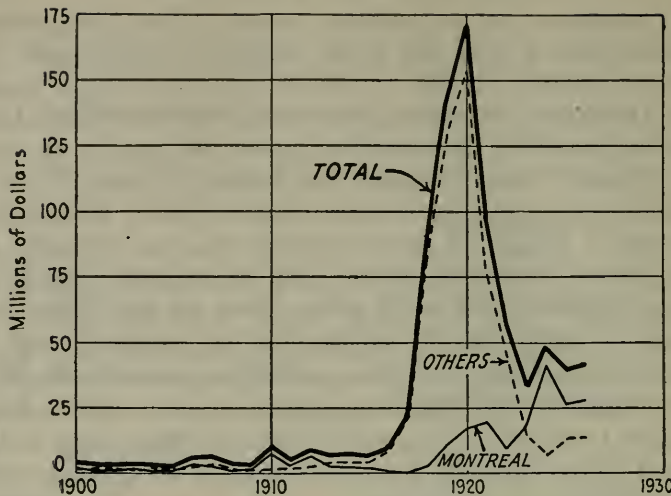
mand deposits or active checking accounts. Nor is the savings depositor given a prior lien on the assets of a failed bank. In matter of priority, the notes constitute the first lien; the claims of the Dominion Government, the second; of the Provincial Governments, the third; the depositors' claims, the fourth. In practice, if there is fear of failure, the demand depositor, if he is sufficiently alert, will protect himself against loss by withdrawing his funds, a course not always open to the time depositor, in whose case a withdrawal notice may be required. Since the savings depositor's lien ranks so far down the list, in law and practice, it seems but reasonable that his deposits should be invested in securities or in forms generally approved by the Minister of Finance which should be segregated and be used in event of failure, to satisfy his demands.[163] The same idea could well be adopted in the National Banking System of the United States where time deposits have grown so rapidly in the past decade that proper safeguards might be thrown around the present tendency toward departmentalization.

Deposits, Government. The Dominion Government places some of its funds with each of the chartered banks, but the bulk (excepting during the war) with the Bank of Montreal, which has been generally regarded as the Government's bank and the principal fiscal agent of the Dominion.[164] The total amount of the deposits of the Dominion and the amount with the Bank of Montreal and the other chartered banks are shown in the chart on page 404. During the war period the Dominion deposits rose sharply and attained in 1920 a maximum of 170 millions of

[163] See remarks of H. C. McLeod, *Minutes of Proceedings, Evidence, etc.*, 1913, p. 175.

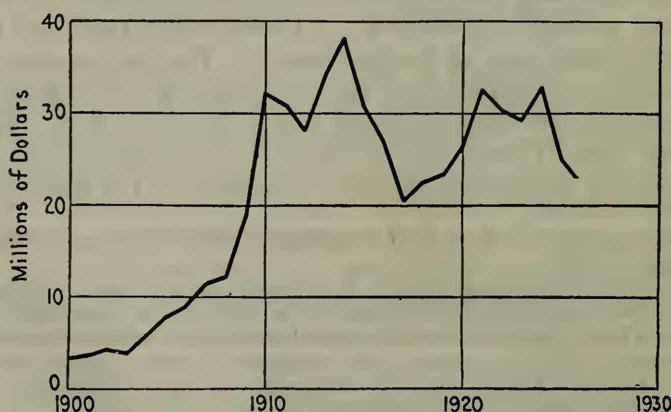
Relative to this proposal, Mr. Henry T. Ross wrote as follows: "If these deposits were segregated and 'invested in securities or in forms approved by the Minister,' the banks would have relatively little funds for commercial banking. To give effect to the suggestion would . . . destroy the present Canadian banking structure and render the continued existence of the Canadian banks and the service they give to the Canadian public impossible. In the past twenty-six years the losses to depositors in Canadian banks have been less than one-half of one per cent of the present deposits, so that it would hardly seem worth while scrapping the structure and all that that entails to insure against a possible loss of this relatively insignificant amount."

[164] See *Interviews on the Banking and Currency Systems of Canada*, p. 154.



Dominion Deposits with the Bank of Montreal and with the Other Chartered Banks

dollars, which were in reality proceeds of war loans pending disbursement. Since then they have fallen rather sharply to about



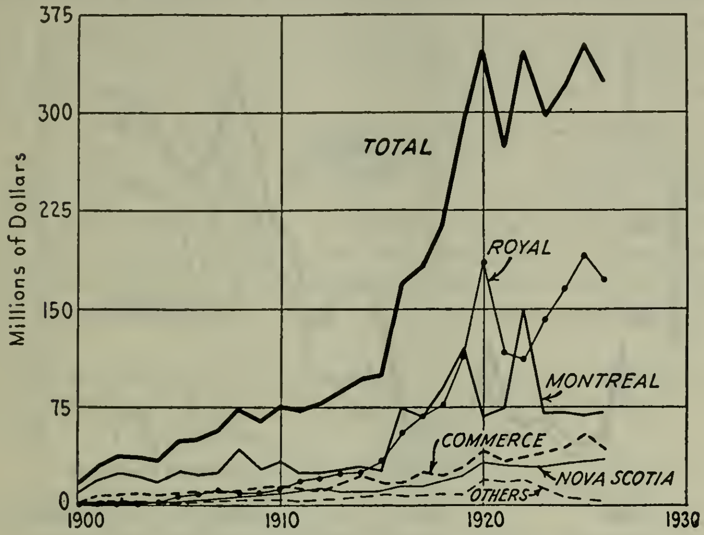
Provincial Government Deposits with the Chartered Banks

one fourth of this amount and are relatively a small item in the total deposits of the chartered banks.[165] The balances due Pro-

[165] Source of data: *Returns of the Chartered Banks.*

vincial governments have fluctuated since 1910 between 20 and 35 millions of dollars and, like the Dominion balances at present, are but a small factor in the total deposits of the chartered banks.

Deposits, Foreign. In 1900 the chartered banks had but 16 millions of dollars of deposits at their foreign offices, of which 10 millions of dollars were held by the Bank of Montreal. Today



Foreign Deposits of the Chartered Banks

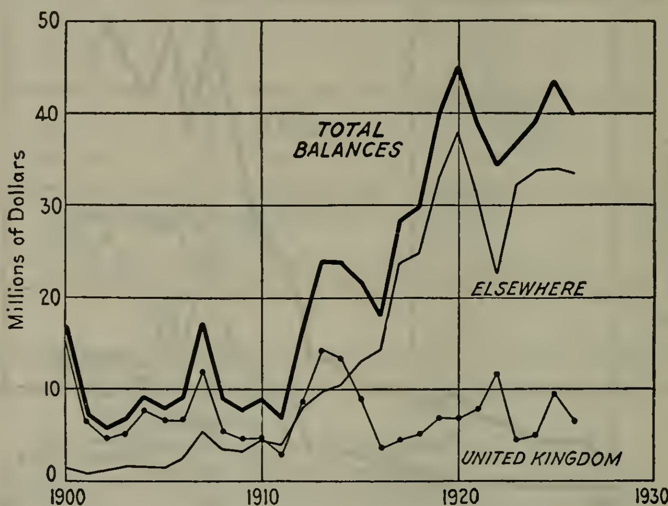
their foreign deposits have increased by twenty-fold, to 324 millions of dollars, of which 172 millions are held by the Royal Bank, 71 millions by the Bank of Montreal, 42 millions by the Bank of Commerce, and 35 millions by the Bank of Nova Scotia. The increase in the foreign deposits of the Royal Bank in particular has been most phenomenal.[166] The growth of these deposits has resulted in part from the expansion of the foreign branches of the chartered banks, and in part from Canada's foreign borrowings.

Foreign deposits present a special problem in that they are subject to wider and more violent fluctuations than domestic. For example, the deposits of the Royal Bank slumped from 180 million dollars in July, 1920, to 111 millions of dollars two years

[166] Source of data: *Returns of the Chartered Banks.*

later. In one year the foreign deposits of the Bank of Montreal dropped from 150 to 70 millions of dollars. Because of these wide oscillations, the best banking policy would be to keep the funds in a most liquid form.[167]

The foreign deposits shown in the previous chart do not include the balances due foreign banks which appear in the accompanying graph. One quite significant trend in these is that while



Deposit Liability of Chartered Banks to Foreign Banks

before the war the balances due to agencies or banks in the United Kingdom were larger than balances due elsewhere, today the reverse is decidedly the case.[168]

The Loans of the Chartered Banks. The necessity for controlling by legislation the type of loans which may be made by national and state banks and the amount of credit which may be

[167] By reason of foreign exchange fluctuations, the reserves and contra-assets for each country's deposits must be native to that country to avoid possibilities of exchange losses. Of course it is true that the years 1920–21 were the years of great fluctuation in banking everywhere and can hardly be selected as typical years. Ordinarily, fluctuations of the foreign deposits of Canadian banks do not vary greatly from the fluctuations in domestic deposits. In the case of the Bank of Montreal, as depositary of the Government it frequently receives in New York the proceeds of a Government loan or else accumulates in New York funds to retire a Government loan.

[168] Source of data: *Returns of the Chartered Banks.*

extended to any one interest is seldom questioned in the United States. In a unit type of banking organization, where the typical institution is small, such mechanistic rules are justifiably embodied in legislation to guide the inexperienced in banking and to bring about a distribution of risk in loans. The chartered banks of Canada as compared with banks in the United States operate under few restrictions as to their loans and investments. Their very size and nation-wide character tend to bring about a desirable distribution of risk and, then again, there have developed banking customs or traditions which are more effective than legal control. Not that we mean to imply that bank management in Canada is ideally perfect and free from flaws. On the contrary, in some instances bank management has been tragically incompetent and in cases actually dishonest. On the whole, however, Canadian bank management has been competent and the abuses which have crept in by reason of the lack of strict legal control over the development of bank portfolios have been relatively few.[169]

Loan Provisions of the Bank Act. A summary of such provisions as appear in the Act follows:

POSITIVE PROVISIONS

A Canadian chartered bank may:

General Powers	deal in, discount and lend money and make advances upon the security of, and take as collateral security for any loan made by it, bills of exchange, promissory notes and other negotiable securities, or the stock, bonds, debentures and obligations of municipal and other corporations, whether secured by mortgage or otherwise, or Dominion, provincial, British, foreign, and other public securities. (Section 75)
	engage in and carry on such business generally as appertains to the business of banking. (Section 75)

[169] Some Canadian authorities favor limiting the amount of loans to any one interest on the ground that some failures in the past have been due to excessively large loans to a single interest.

Gold Coin and Bullion	engage in and carry on business as a dealer in gold and silver coin and bullion. (Section 75)
Timber Loans	lend money upon the security of standing timber or the rights or licenses held by persons to cut or remove such timber; provided that if the provincial law permits, the instrument evidencing such security is registered against the land upon which such timber stands or in the offices in which are recorded such rights or licenses. (Section 83)
Loans to Receivers	lend money to a receiver, to a receiver and manager, to a liquidator appointed under any *Winding-up Act,* or to a custodian, interim receiver, or trustee under *The Bankruptcy Act,* provided such receiver, receiver and manager, liquidator, custodian, interim receiver, or trustee, has been duly authorized or empowered to borrow, and, in respect of any money so lent, the bank may take security, with or without personal liability, from such receiver, receiver and manager, liquidator, custodian, interim receiver or trustee to such an amount, and upon such property and assets, as may be directed or authorized by any court of competent jurisdiction. (Section 84)
Loans to Wholesale Dealers	lend money to any wholesale purchaser or shipper of or dealer in products of agriculture, the forest, quarry and mine, or the sea, lakes and rivers, or to any wholesale purchaser or shipper of or dealer in live stock or dead stock or the products thereof, upon the security of such products, or of such live stock or dead stock or the products thereof. (Section 88)

Loans on Grain	lend money to a farmer upon the security of his threshed grain grown upon the farm. (Section 88)
Loans to Manufacturers	lend money to any person engaged in business as a wholesale manufacturer of any goods, wares and merchandise, upon the security of the goods, wares and merchandise manufactured by him, or procured for such manufacture. (Section 88)
Seed Grain	lend money to the owner, tenant or occupier of land for the purchase of seed grain upon the security of any crop to be grown from such seed grain. (Section 88)
Loans for Live Stock Raising	lend money to a farmer and to any person engaged in stock raising upon the security of his live stock; provided however that such security shall not include and shall be deemed not to include any live stock which at the date of the coming into force of this Act is by any statutory enactment exempt from seizure under writs of execution. The provisions of subsection 4 of this section making live stock substituted for live stock removed subject to the security, shall apply to the live stock substituted by the farmer or other person engaged in stock raising. " Live Stock " for the purposes of this section means horses and mares, bulls, cows, oxen, bullocks, steers, heifers and calves, sheep and swine and the offspring of any of such animals. (Section 88)

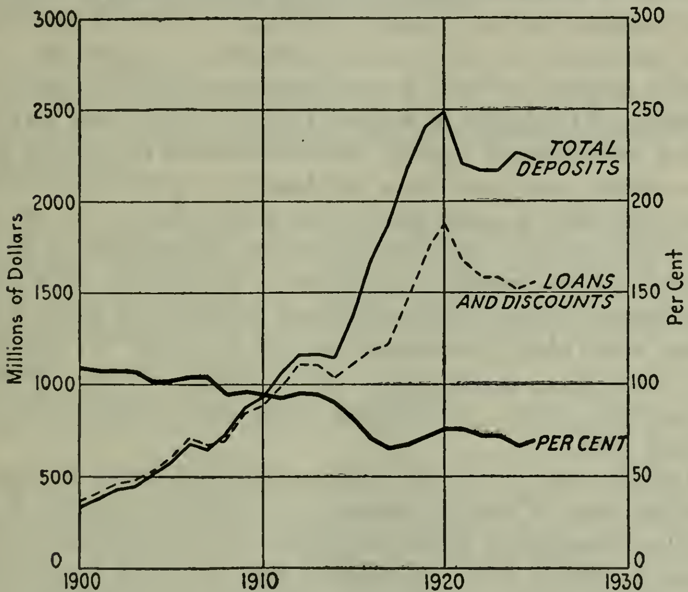
NEGATIVE PROVISIONS

A chartered bank may not, except as authorized by the Act, directly or indirectly:

Goods and Merchandise	deal in the buying or selling, or bartering of goods, wares and merchandise, or engage or be engaged in any trade or business whatsoever. (Section 75)
Loans on Own Stock	purchase, or deal in, or lend money, or make advances upon the security or pledge of any share of its own capital stock, or of the capital stock of any bank. (Section 75)
Loans on Mortgage	lend money or make advances upon the security, mortgage or hypothecation of any lands, tenements or immovable property, or of any ships or other vessels, or upon the security of any goods, wares and merchandise. (Section 75)
Loans to Managers and Employees	lend to or on the security of the general manager, assistant general manager, branch manager, or any officer, clerk or servant of the bank without the approval of the directors any amount or amounts exceeding in the aggregate one thousand dollars. (Section 75)
	lend to or on the security of the general manager, assistant general manager, branch manager, or any officer, clerk or servant of the bank any amount or amounts exceeding in the aggregate ten thousand dollars. (Section 75)
Loans to Directors	lend money or make advances in excess of ten per cent of its paid-up capital to a director of the bank or to any company or corporation in which the president, general manager or a director of the bank is a partner or shareholder, as the case may be, without the approval of two-thirds of the directors present at a regular meeting, or meeting specially called for the purpose, of the board.[170]

[170] The Canadian law does not limit the amount which may be loaned to any one interest. Mr. H. C. McLeod in 1913 suggested as a limit 25% of capital. *Minutes of Proceedings, Evidence, etc.*, 1913, p. 111.

LOAN DEPOSIT RATIO. The monthly returns list under ten categories the loans of the chartered banks. The most important and the one which includes the bulk of the commercial loans in Canada is that headed, "Other current loans and discounts in Canada." On July 31, 1926, this amounted to nearly 942 millions of dollars which was equal to less than half of the demand and time deposits of the banks. Even total loans were considerably less. Twenty-five years ago the reverse was true, total loans were then larger than deposits. The difference was contributed from the capital funds of the banks. But in the meantime, as indicated in the following chart, deposits have grown and, especially since 1913, much more rapidly than loans.[171]



THE PER CENT RELATIONSHIP BETWEEN THE TOTAL DEPOSITS AND THE TOTAL LOANS AND DISCOUNTS OF THE CHARTERED BANKS

Though for the entire banking system, deposits are greater than loans, in many sections the opposite is true. It is one of the marked advantages of a nation-wide system of branches that a shifting of funds may take place from those parts where there is

[171] Source of data: *Returns of the Chartered Banks.*

an excess of deposits, where deposits are not absorbed entirely by local credit needs, to rapidly developing sections, standing in great need of credit and unable to be self-financing. This is one of the admirable qualities of the Canadian banking system and has meant much as a factor in the development of the grain Provinces. To some extent funds are shifted about in the United States and yet in a relatively crude cumbersome fashion when compared with the ease in the mobility of funds in Canada. Commercial paper houses [172] and note brokers help to bring about a sectional mobility of funds in the United States and have been an important factor in making the unit banking system work. Then, again, interior banks borrow from their correspondents in the East or in large centers or from the Federal Reserve Banks to meet seasonal and on occasion cyclic needs. But the borrowing unit banks can not be financed continuously to meet the constantly growing needs of a developing community, as may the branches of the banks in Western Canada whose loans may for a long period exceed deposits. Branch banking then serves best new sections and would be a real benefit, if properly controlled and supervised, to many parts of the United States. To an old, relatively wealthy, and long-established community as is the State of Massachusetts, it would be of little value. The local loan demand is small and not sufficient to absorb the funds of the banks which place their excess resources in bonds [173] or commercial paper, thus making for a diversification of risk. With a nation-wide system of branches these excess funds could be shifted West.

The financing of less developed regions in Canada through a shifting about of banking resources was touched on by Mr. C. E. Neill in his testimony before the Committee on Banking and Commerce in 1924 in which he indicated that the excess resources of British Columbia and the Maritime Provinces are utilized by the Prairie Provinces: [174]

[172] Only occasionally do the note brokers operate in Canada, in the main a business man relies for his funds entirely on one bank. *Minutes of Proceedings, Evidence, etc.*, 1913, pp. 171 and 311.

[173] In the past in corporate and municipal securities of which there has been an abundance coincident with America's rapid development. In the future these excess funds will be invested probably to a larger extent in foreign securities.

[174] p. 265.

Q. Would you say whether there is any comparison as to depositors in any given district — say my own province of British Columbia — as to the difference between the loans and deposits?

A. I should say that in British Columbia the deposits are higher than the loans.

* * *

Q. I cited British Columbia not because I lived there but merely as a unit. How about the other three western provinces? How will the loans and deposits compare? — A. I think in the Middle West the people have a larger proportion of loans than any other district.

Q. As compared with their deposits? — Yes, I think they have received much the most liberal treatment.

By Mr. Hanson:

Q. How about the Maritime Provinces? — A. Of course, the Maritime Provinces are really more of a depositing centre than a loan center.

In his testimony in 1913 Sir Edmund Walker revealed that at the 122 western branches of the Canadian Bank of Commerce, in the Prairie Provinces, farmers' deposits amounted to $2,869,926 and loans to farmers amounted to $13,035,784, or nearly five times as much.[175] At the same hearings Mr. H. O. Powell, as the result of banking experience in both the Dakotas and Canada, declared that farmer borrowers got practically twice as much credit from the banks in the Dominion.[176] By way of summary, the development of the Canadian West has been made possible through the bank deposits of other sections. Funds have been shifted to points of greatest need and incidentally the resources of the banks have been greatly diversified. The risk has been distributed.[177]

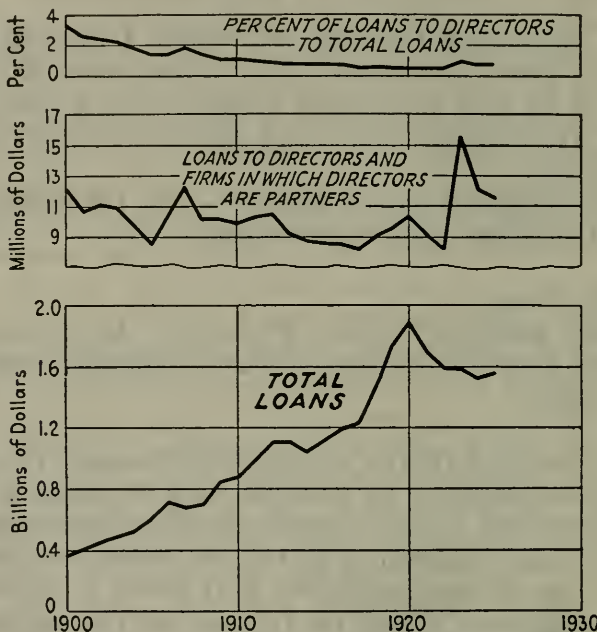
Loans to Directors. For some years the returns of the chartered banks have given data regarding the amount of loans made to directors and to firms in which they were partners. Such data are important since banks are prone to succumb to the temptation

[175] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 484. See also p. 577.

[176] *Ibid.*, p. 428.

[177] See *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 447.

of lending an undue amount in this fashion. The amount of such loans and the per cent they bear to the total of call and other current loans and discounts in Canada are given in the following table. The per cent of such loans is not as large today as in 1900.[178]



The Amount of Loans Extended by the Chartered Banks to Their Directors Has Declined Since 1900

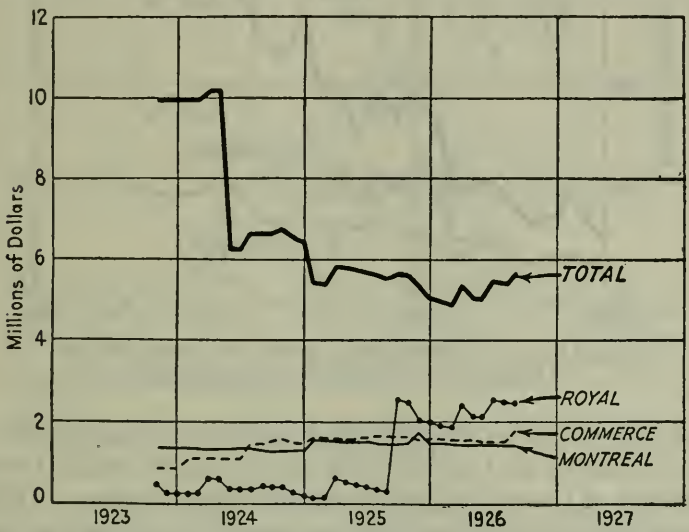
Sir Edmund Walker made the following rather pertinent observations relative to directors' loans: [179]

The matter of loans to directors has always been a difficult question, for which no more satisfactory solution has been found than to permit comparative freedom, except that in the monthly return the aggregate of loans to directors must be shown. . . . Two points in this connection are clear. If a bank has a board consisting entirely of directors who do not borrow, it runs great risk

[178] Source of data: *Returns of the Chartered Banks.*
[179] *Canadian Banking,* by Sir Edmund Walker, pp. 15–16.

of not being in touch with the active business community; because until Canada is a much richer country, the business men still in the prime of life are likely to be borrowers. On the other hand, as long as directors are allowed to borrow from the bank at whose board they have a seat, there will be losses, and, occasionally, losses not justifiable.

Shares of and Loans to Controlled Companies. Since October, 1923, the ownership of the shares of, and the loans to, controlled companies have been included in the returns. The totals for the three largest banks and for all are shown in the following chart.[180] At the present time, the only banks which have such loans or shares are Montreal, Commerce, and Royal.[181]



The Ownership of Shares of and Loans to Controlled Companies

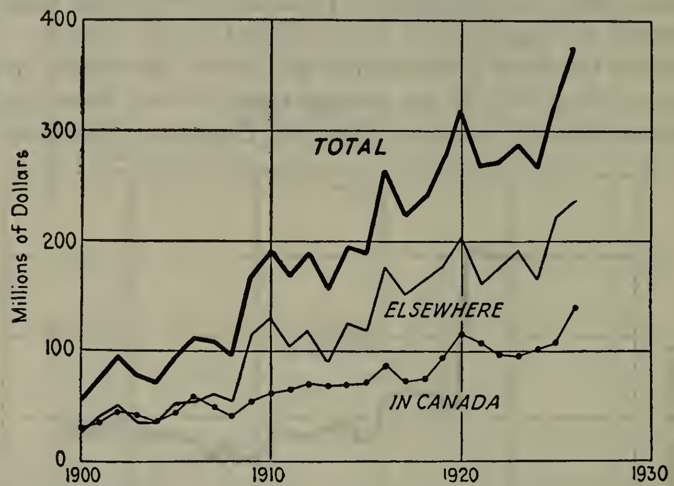
Call and Short Loans. While the chartered banks make what are termed call loans in Canada, there is in fact no true call market in the Dominion. As the accompanying chart indicates, there are now but 140 millions of dollars on call in Canada which makes for a restricted, inelastic and non-resilient market.

[180] Source of data· *Returns of the Chartered Banks.*

[181] Regarding the danger of affiliated institutions see Mr. H. C. McLeod's testimony in 1913, p. 120.

Should any single bank call its loans, the market would be thrown into a panic and for that reason some of the banks do not show such loans in the call column. From 1920, the peak of the boom period, to 1923, the total of these loans declined by only twenty million dollars.[182]

The totals of the call loans elsewhere are now about 100 million dollars greater than call loans in Canada. These are for the



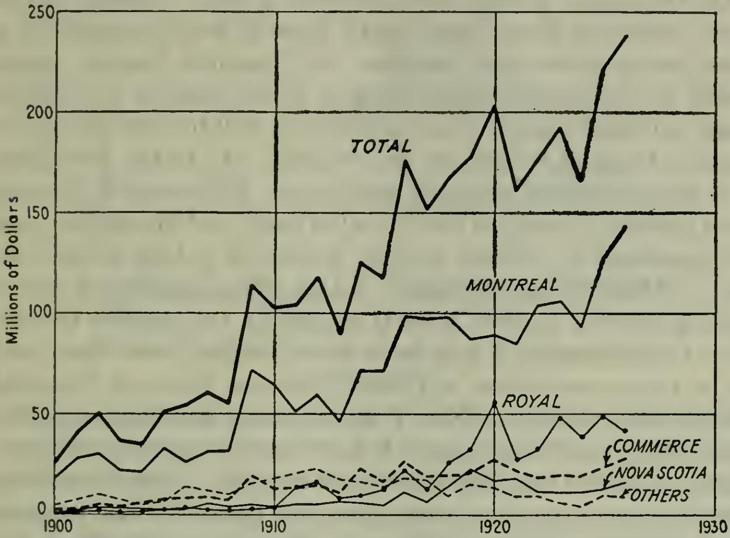
THE CALL AND SHORT LOANS OF THE CHARTERED BANKS EXTENDED IN CANADA AND ELSEWHERE

most part placed on the New York market and can readily be called owing to the breadth of the market and its ability to rely indirectly on the credit elasticity of the Reserve System. All but a small percentage of these loans are placed by the " big four " and at that, the bulk by the Bank of Montreal, as reserve against the Dominion deposits. The Canadian banks have been criticized for placing their funds on call in New York and so, claim the critics, of depriving legitimate industry, agriculture, and commerce of needed funds. But as the Canadian banks point out the New York market, in the absence of a call loan or discount market in Canada, is used as a depository of surplus funds, of a portion

[182] Source of data: *Returns of the Chartered Banks.* On several occasions, of course, Canadian banks could not call their loans in the New York call loan market.

of the reserves of the chartered banks which are withdrawn without hesitation in case of need.[183] Sir Edmund Walker traced the origin and historical development of this practice in testifying in 1923.[184]

Q. I have just a few questions I would like to ask. The statement I am referring to is dated February, which is characteristic I think of most of the bank statements. I wish to ask you, Sir



THE CALL AND SHORT LOANS PLACED ELSEWHERE THAN IN CANADA BY CHARTERED BANKS

Edmund, to give a clear, frank expression, as you have so kindly done, in most instances, to the necessity for loaning on call loan, elsewhere than in Canada the sum of $181,000,000, and other loans, $165,000,000 or a total of $347,000,000; the necessity for that and also at the same time would you not consider that

[183] Disregarding the call loans abroad which might be considered as part of their reserves, the banks frequently have larger foreign deposits than loans. See *Minutes of Proceedings, Evidence, etc.*, 1913, pp. 160, 161 and 536. One reason for the increasing amount of foreign call loans of the Canadian banks has been the favorable balance of the trade of the Dominion.

[184] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 522.

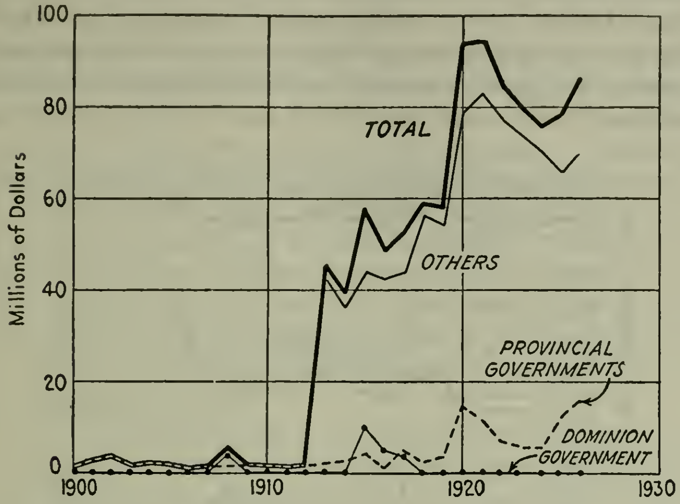
the withdrawal of part of that call loan for instance and its use in Canada at this time might have a beneficial effect on Canadian business? — A. I think you did not quote the deposits in foreign countries.

Q. I did not. The deposits I might say are $325,000,000. The loans are $347,000,000. — A. So that there is $20,000,000 we have to deal with. A very small reserve surely for the Canadian business.

Q. The reason I asked that question is this. Frankly it has been a criticism in my mind, and I know it is in the minds of a great many others that perhaps the Canadian bankers might bring, for the present rather stringent period, some of this money back to Canada, and I think it would be well for the bankers to make a frank statement on the subject. — A. In the first place it is not a stringent period in that sense. The banks of Canada have plenty of money to lend; it is the quality of the security and the condition of business, and the volume of it that is the difficulty. Money is not stringent. So far as the question of carrying our reserves in New York is concerned, the practice is older than Confederation, it goes back to the sixties, when there used to be bitter complaints in Ontario that the Bank of Montreal would lend its money in New York but would not lend to the Ontario farmers and merchants. It has come up regularly and been answered just as regularly over and over again. Canada has been saved almost every time when there has been a serious panic in the United States by our ability to withdraw from New York our balances there to serve our people at home. Saved in '93, saved in '97, saved many, many times. The amount in New York must be added to the cash reserves in Canada, and then you must consider whether those reserves as a whole are too much for the volume of business. But when we have times like the present, it is not that the banks have money to lend, it is that the people have not the transactions to offer to the bank that are suitable for good loans.

Loans to Governmental Authorities. The loans to governmental authorities have on the whole constituted a small proportion of the total loans of the chartered banks, as the next chart shows. It is interesting that loans to cities, towns, municipalities,

and school districts have constituted the bulk of the loans and that loans to the Dominion have been few and far between.[185]



LOANS BY THE CHARTERED BANKS TO GOVERNMENTAL AUTHORITIES

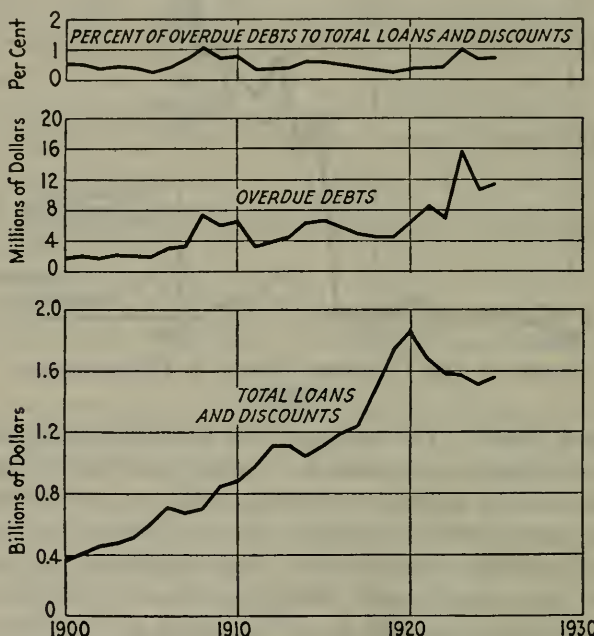
OVERDUE DEBTS. The returns of the chartered banks have for many years carried an item known as "overdue debts" the meaning of which until the revision of 1923 was left to the judgment of each banker. At that time the phrase "non-current loans, estimated loss provided for" was substituted (section 113) and this was carefully and minutely defined in the Bank Act. From the chart on p. 420 it is interesting to observe the relation of overdue debts to fluctuations in business conditions. This item was largest in the depression years of 1908 and 1923 and smallest in the boom times of 1906 and 1919.[186]

SECTION 88. One of the most interesting features in the Canadian Bank Act is the special protection accorded banks in the making of certain types of loans by the quite famous section 88, of the Bank Act, as supplemented and enlarged by Section 89. A bank in making loans to wholesalers, purchasers or shippers

[185] Source of data: *Returns of the Chartered Banks.* Data as of the last banking day in July of each year.

[186] Source of data: *Returns of the Chartered Banks.* Data as of the last banking day in December of each year.

of or dealers in the products of "agriculture, the forest, quarry and mine, or the sea, lakes and rivers, or to any wholesale purchaser or shipper of or dealer in live stock or dead stock or the products thereof," or to a farmer upon the security of his threshed grain, or to any person engaged in business as a wholesale manufacturer of any goods, wares and merchandise may acquire special protection [187] or security by virtue of which the same legal rights



The Per Cent Amount of Overdue Debts Shows a High Increase in Years of Depression

are acquired as would have been obtained by a warehouse receipt. In other words, a bank acquires by reason of these provisions a first and preferential lien [188] upon products handled by wholesale purchasers, shippers, dealers or manufacturers through the various processes of trade and manufacture. The banker becomes for all practical purposes sort of a silent partner in busi-

[187] See Schedule C of Act.

[188] Secondary, however, to wages and salaries owing for a period not exceeding three months.

ness and agriculture.[189] The borrower is in no way embarrassed for he has the same right to buy and sell as he would were he under no obligation to the bank. If he should adopt a policy of which the lending bank disapproved, the banker might take immediate possession of his stock of goods. A bank's lien upon property accepted as security for a loan, under section 88, is superior to that of any unpaid vender unless the vender's claim was known to the bank when it accepted the goods as security. Further, in case goods, upon the security of which money has been loaned, are removed and other products substituted, the bank shall acquire the same rights in respect to these as it had in respect to the original commodities. These provisions have contributed greatly to the strength of the assets of the Canadian banks, for banks which advance funds in this fashion have a prior claim upon the goods loaned upon as they are fabricated or as they come and go in the course of trade.

The reason for section 88, a provision peculiar, with the exception of Newfoundland, to the Canadian Bank Act, was explained at some length by Sir Edmund Walker in the 1923 hearings: [190]

Referring to 88, in the early days in this country where the lumberman and the mover of any kind of our early products needed help from the bank, he had capital very small indeed in proportion to his requirements. He could himself be a bailee. He could issue a warehouse receipt himself. There were several different things on which you could take a lien for a bank, but it was illogical, and did not go far enough. We framed section 88 in order that the manufacturer in Canada or the man who was taking out a raw product of any kind or was moving wheat to the market, particularly wheat to a flour mill, could borrow from the bank without endorsers or anything of that kind, by pledging the material to the bank. It was based upon the idea that in the overwhelming bulk of the cases cash is paid for the raw material, and cash is paid for the labour, and no injustice could be done to anyone in cases of that sort.

[189] See House of Commons Debates, 1913, pp. 2287, 2494–2498, and *Minutes of Proceedings, Evidence, etc.*, 1913, pp. 407, 421 and 571.

[190] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, pp. 523–524. See also *Minutes, Proceedings, Evidence, etc.*, 1913, p. 280.

Mr. Beaudry Leman, General-Manager of the Banque d'Hochelaga, warmly defended this section in the same hearings as having rendered considerable and valuable service to the country: [191]

As far as we are concerned the operations of section 88 are concerned mostly with lumbering operations, with the lumber, paper, pulp industries, where the large advances which are necessary almost every year for the lumbering operations are covered by a security under section 88: aside from that we have had some experience in the shoe industry, making advances on the raw materials used in the manufacture of shoes. Personally, I believe the great majority of all manufacturers and all the business community are honest men, and they have used section 88 as it was intended by Parliament; when they have obtained from the banks money on the security of those raw materials, they have paid both their labour to secure the raw materials or other manufacturers who were producers of those raw materials. . . . We must realize that the accumulated wealth in this country is not so large as it is in other communities, and that a great many of our concerns, particularly of the smaller sort, start out in business, in a very legitimate business, with a small or relatively small margin of working capital and this has enabled the banks to go and help them along the line of developing production, particularly our great natural resources.

And to quote one more witness, Sir Frederick Williams-Taylor declared flatly that Canada's development was due to a considerable extent to this provision: [192]

Section 88 of the Bank Act, which is the section you refer to, was enacted a great many years ago; it was conceived not in the interests of the banks, but in the interests of a community where the amount of accumulated wealth was naturally small, this being a new country, and it was a very ingenious and excellent conception, and the benefits that have accrued to this country in consequence of it are in my opinion and the opinion of all the

[191] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 636.

[192] *Ibid.,* pp. 328–329.

bankers in Canada, and I think the great bulk of the community who have to do with section 88, quite incalculable. It would be quite impossible for Canada to have developed in the way that Canada has developed without section 88. May I give you an illustration, Mr. Woodsworth, because this is an important matter and I would like to say a word or two about it.

An individual or group of individuals have a capital of, say, a million dollars, and they desire to go into a manufacturing business of some nature or other. It is necessary for the conduct of that business that they should have premises. They put $750,000 of their capital into their plant, leaving them with $250,000 of working capital. Now the amount of money that could be borrowed from a bank, without section 88, would be in strict keeping with their working capital, a bank might loan a similar amount, say $250,000 more; so that with their own $250,000 and the $250,000 provided by the bank, the company would have $500,000 of working capital at its disposal with which to operate a plant that cost $750,000. Now under the wise provision of section 88, which gives a bank a first lien on this security, provided the money is advanced at the time — and that is a very important feature, a bank cannot take a security receipt except against a loan made concurrently. Now as I say under this wise section 88, a bank can take a first lien on the goods of the manufacturer, and it enables the bank to lend the manufacturer, not $250,000 but possibly three times that amount, and thus enables the manufacturer with a limited amount of working capital, to treble his turnover and earn dividends in keeping with the amount of money invested in his plant.

In the 1923 revision it was provided (section 88a) that borrowings under section 88 should be registered to give due warning to all other creditors of the bank's prior lien. It was pointed out by witnesses appearing before the Banking and Commerce Committee that the creditors of an insolvent individual or firm were not given sufficient protection in view of the preferential lien of a bank and that advantage was taken of this section by unscrupulous traders who would purchase goods on credit and then borrow on the security of these from banks under this section. One of the

witnesses who laid particular stress on the necessity of registration was Mr. H. T. Tulloch, representing various Chambers of Commerce in England. He cited several cases as illustrative of the hardships imposed on British firms by reason of this provision. One of the cases which he cited follows: [193]

This is a shipment of goods that was made in November, the order was placed in November, 1919, and the goods were shipped over various periods; the total amount of the goods was £2,807; no payments were ever received, nor any complaints, but the customer wrote in September, 1920, stating that the goods were imperfect, and he consequently refused to accept them, and they were left in his premises at the English firm's disposal, and would they please give forwarding instructions. Owing to some mischance that letter went astray and it was returned to the Canadian firm. The agent of the English firm got in touch with the Canadian firm and agreed to the return of these goods, stating that he would give an address in Montreal to which the goods could be delivered on their account. On calling the next day to give this address, our agent learned that after his departure the previous day the bank had foreclosed, and refused to part with the goods. Our agent immediately interviewed his lawyers, who advised him that as the goods were only transiently in possession of the holder they would undoubtedly be handed over as soon as the bank had ascertained which goods in the premises belonged to the estate, and which did not; and he need have no misgivings. After the inventory was taken the bank claimed that the goods, of which fifty pieces were in the customer's warehouse and twenty-five pieces still remained in bond, were part of the estate, and refused to release them. Eventually the matter went to court and judgment was given in January, 1921, against us; so that the goods were entirely lost to us, and in addition we had to pay the legal expense. The estate is bankrupt, and there is no dividend for any creditor excepting the bank. We believed we had a clear case. Under the Canadian law we lost it; and this experience naturally had an adverse influence on our later settlement with the Canadian customers.

[193] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, pp. 189–190.

The witness then explained that as Canadian firms were not strong enough to pay for imports in cash against documents and that as at least 60 days credit had to be given,[194] the registration of such loans should be required to protect British firms against unscrupulous traders. Much the same opinion was held by Mr. Fielding, the Minister of Finance, who explained to the Committee the need for the registration of the $200,000,000 of loans outstanding under this section: [195]

The purpose was to give a warning; any man who wants to make use of that can do so. It will be no mark of discredit to be registered under that act; the biggest concerns in Canada will do it. This is not only a Bradford matter; there are Canadians who have complained bitterly of this priority given to the banks. Many Canadian citizens have complained bitterly over the bank having that priority. Now, what we do is simply to say that anybody trading under that shall register, and the world shall know it. If, in the face of that, they want to lend money, they can go on and do it, but they get the warning.

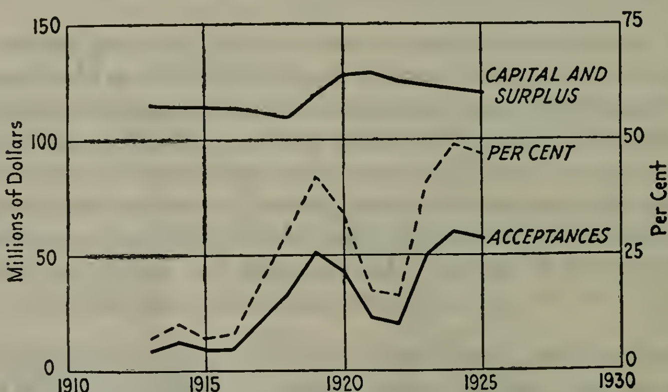
In the Act as adopted it was provided that any person intending to give a bank security under the provisions of section 88 must register notice of such intent (which shall be deemed notice in respect of all securities taken by the bank from such person during the period of three years after date of registration) in the office of the Assistant Receiver General in the province in which the place of business, or principal place of business or residence of the person is situated. Anyone, upon the payment of certain fees, is given the right of inspecting the registration books.

ACCEPTANCES. The larger chartered banks have for many years been actively engaged in the financing of foreign trade and have been active participants in the foreign exchange market. At one time they were among the heaviest traders in sterling in North America. In fact it is stated that prior to the Civil War, the agency of the Bank of Montreal in New York along with Brown

[194] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 194.

[195] *Ibid.*, pp. 843 and 901. See also *Journal of Canadian Bankers' Association*, May and October, 1924, and *The Monetary Times* (Toronto), Vol. 66, p. 22.

Brothers was the dominating factor in the sterling market. To-day, as indicated elsewhere, the Canadian banks have established branches or agencies in many parts of the world, their international connections are most extensive and their foreign operations are of considerable prominence. In the volume of transactions, the Royal Bank occupies the premier position, followed by Commerce, Montreal, and Nova Scotia.[196] The extent to which the Canadian banks engage in the financing of foreign trade is reflected in the accompanying chart which gives as of the last banking day in December of each year since 1913 (the first year this item was included in the returns) the amount of acceptances outstanding issued under letters of credit. Since the amount of bills of exchange which a member bank in the United States may accept is directly proportionate to capital and surplus, the relation of these items is also shown. Though no definite ratio is stipulated by Canadian law, but as will be noted, the ratio of acceptances to paid-up capital and surplus has fluctuated from 7% to as high as 49%.[197]



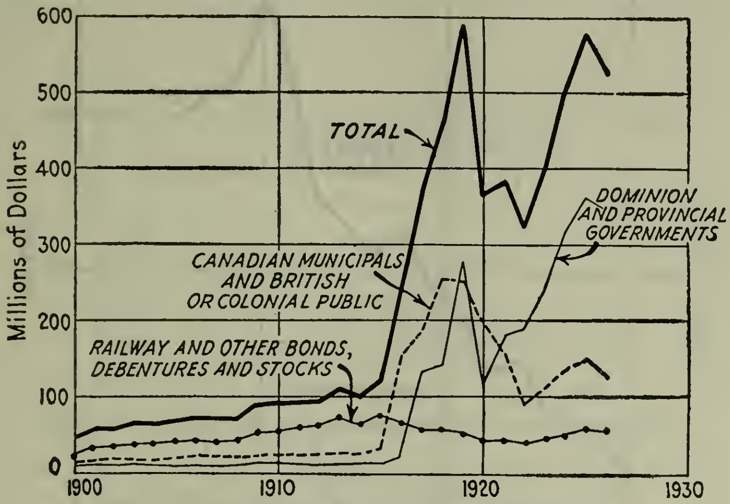
FLUCTUATIONS OF ACCEPTANCES IN PER CENT OF CAPITAL AND SURPLUS

INVESTMENTS. Though the chartered banks are primarily commercial institutions, a considerable, and a steadily increasing amount of their funds is being placed in bond investments, which

[196] The letters of credit are now customarily issued in dollars rather than in sterling by reason of changed trade conditions.

[197] Source of data: *Returns of the Chartered Banks.*

amount at the present time to about one-fifth of their total resources. This is about equal to the ratio of the investments to the assets of National Banks. The returns of the banks divide their security holdings into three categories: (1) Dominion and Provincial Government securities, (2) Canadian municipal securities and British or Colonial public securities (other than Canadian), and (3) railway and other bonds, debentures and stocks.[198] Fluctuations in these are shown in the accompanying chart: [199]



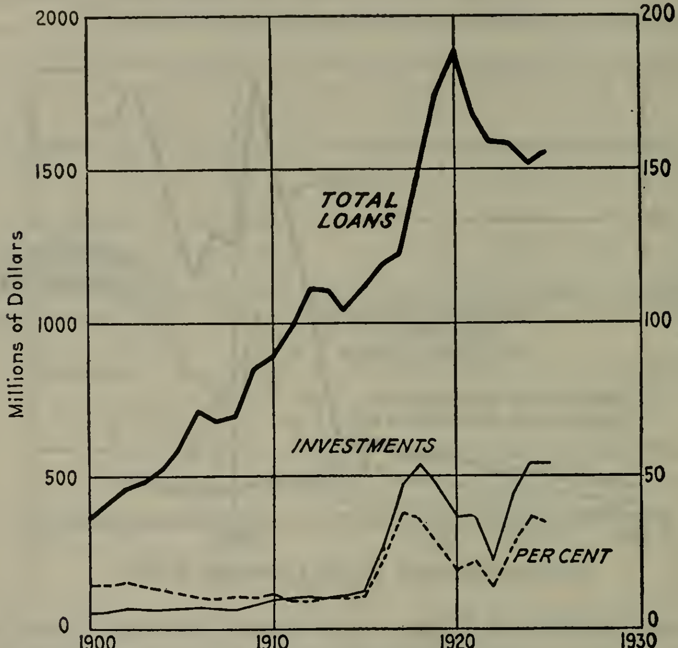
SECURITY HOLDINGS OF THE CHARTERED BANKS

INVESTMENT-LOAN RATIO. In the next chart total loans and investments are compared, as well as the ratio between these two series. From 1900 to 1913 loans were increasing at a more rapid rate than investments, but coincident with war financing the latter grew rapidly, attaining the relative highest point in 1917. Following this there was a decline in the ratio continuing until 1922 with a subsequent increase which is probably due to changes

[198] Mr. H. C. McLeod advocated in 1913 that each bank should annually publish a list of its investments, a practice which had been followed by the Bank of Nova Scotia. (*Minutes of Proceedings, Evidence, etc.*, 1913, p. 110.)

[199] The large holdings in 1910 were due to war loans. Securities were gradually passed on to the investors. Source of data: *Returns of the Chartered Banks*. Data as of last banking day in July of each year.

which have taken place in methods of domestic financing. The larger businesses, by reason of the current practice of "hand-to-mouth" buying have been less dependent on bank loans. This lessened demand for credit released a portion of the banks' resources which have been placed in investments or on the call loan market of New York.[200]



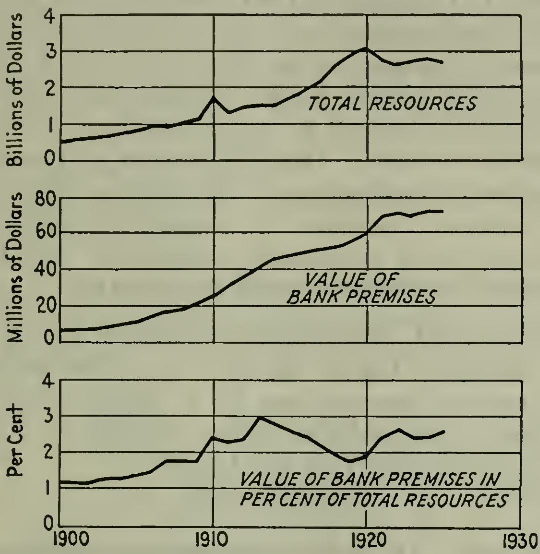
FLUCTUATIONS OF SECURITY HOLDINGS OF THE CHARTERED BANKS COMPARED WITH TOTAL LOANS

BANK PREMISES. Considerable criticism has been directed at the chartered banks for their very heavy investments in their premises. Statements to this effect were made in the 1913 hearings and debates on the Bank Act and again in 1923. That a larger per cent of the resources of the banks is now invested in bank premises than at the beginning of the century is clearly shown in the accompanying chart. In 1900 bank premises repre-

[200] See article by J. Courtland Elliott in *The Annalist*, January 14, 1927, pp. 57–58. Source of data: *Returns of the Chartered Banks*.

sented 1.2% of total assets, whereas in 1925 they represented 2.6 per cent.

In his testimony in 1923 Sir Edmund Walker explained the growth of this item in terms of the Western expansion of his institution. Before 1900, he said, the policy of his bank was to rent offices in all moderately-sized towns and to own only in large cities. However, when the bank expanded to the West, it was found that there were no landlords, that offices had to be built. Some were even constructed in British Columbia in sections and



Value of Bank Premises in Per Cent of Total Resources is Considerably Higher Now Than in 1900

carried on trains to the prairies.[201] In its annual report for 1924 [202] the Royal Bank defended as quite necessary the investments in buildings in order to have conveniently located buildings of adequate size. Be that as it may, the investments in bank premises seem unduly high. As a percentage of paid-up capital and surplus, bank premises amount to almost 30 per cent.[203] In

[201] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, pp. 530–531.

[202] See p. 8.

[203] Return of July 31, 1926.

1890 bank premises amounted to but 5.11% of paid-up capital and surplus; in 1900, to 6.39%; in 1910, to 13.72%; in 1920, to 23.13%. The growth is an unfortunate and unhealthy tendency. Not alone is it questionable to have about one-third of capital and surplus represented in bank premises, but in some cases these have not been written down as rapidly as desirable. Bank premises should, according to an eminent Canadian banker, be written down by at least one sixth each year.[204]

Reserves. To the banker in the United States the term reserve has a strictly legal connotation, the size of the deposit which he, if his institution is a member of the Federal Reserve System, must maintain with the Reserve Bank. The chartered banks, on the other hand, are not required by law to maintain fixed or definite reserves against deposits. The legal concept of reserve is foreign to bankers in the Dominion. Nevertheless, they do have a most clear economic concept of the necessity of holding reserves and of the most liquid or realizable constituents. The Canadian banker thinks of his reserve as being composed of:

(1) Cash on hand. This amounts usually to 10% or more of net liabilities, but as the chart on p. 434 indicates has fluctuated all the way from 7.9 to 15.4 per cent.
(2) Deposits with banks in foreign countries.
(3) Call loans in New York and London.
(4) Securities and commercial paper.

Cash on Hand. The cash holdings are not concentrated in one location, but are distributed by the banks among those branches where the need will be greatest and particularly where clearing house settlements are apt to be largest. In testifying before representatives of the National Monetary Commission, Mr. Coulson, a Canadian banker, declared that there was an understanding among members of the Bankers' Association that they were to maintain in cash an amount equal to 15% — he probably meant of deposits, though this was not made clear.[205] While the amount of cash reserve required to be held is not stipulated, by section 60 of the Bank Act it is provided that each chartered bank must hold

[204] H. C. McLeod.

[205] *Interview on the Banking and Currency Systems of Canada,* pp. 41–44.

Dominion notes to the extent of 40% of such cash reserves as are maintained in Canada. The reason for this provision was explained by Sir Edmund Walker in testifying in 1913 as follows: [206]

> English and American bankers often ask why the Act contains this 40 per cent provision. It is a thing that was put into the Act at the time of Confederation because Nova Scotia and Old Canada had issued legal tender notes. They amounted to less than $5,000,000, but the new Dominion of Canada was so poor that it could not afford to pay them off. So it also began the issue of legal tender money — not secured, or only partially secured, by gold — and in order to force the banks to carry these legal tenders, they put into the Bank Act a provision that whatever reserves the bank carried 40 per cent must be in legal tender notes. That provision ought to come out of the Act because it has no longer any significance.[207]
>
> Q. Does the provision serve any purpose today? — A. It does not serve any good purpose.

One interesting feature of the chart at the top of the next page, showing the constituent parts of the cash holdings of the chartered banks, is the increase in recent years of holdings of United States and foreign currencies:

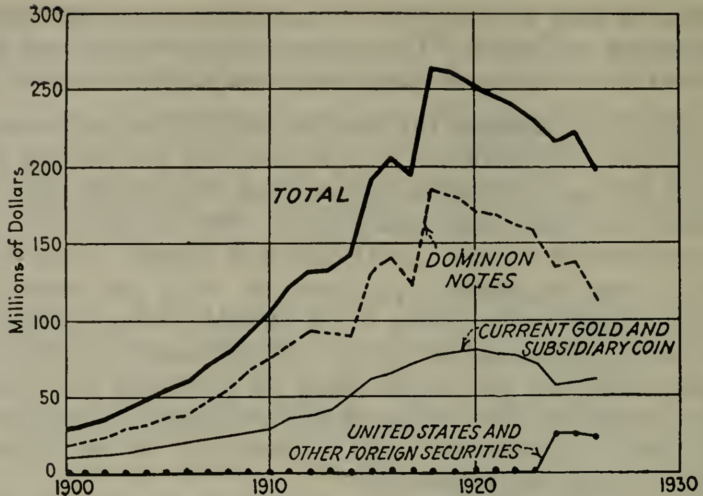
Deposits as Reserves. The volume of deposits due the chartered banks from foreign banks are represented in the chart at the bottom of the next page. The amount on deposits now with banks in the United Kingdom amounts to only 15% of the total. The remainder is held mainly in banks in the United States. The close economic ties between the two countries would be one factor accounting for the greater proportion of deposits in New York. Another is that from 1914 until April of 1925 England was on the paper basis while the United States maintained a free gold market.[208] The bulk of the deposits held in England by the chartered banks are those of the Bank of Montreal.[209]

[206] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 580.

[207] During the war the character of Dominion notes was considerably changed, see pp. 387–401. Source of data for chart: *Returns of the Chartered Banks*. Data as of last banking day in July each year.

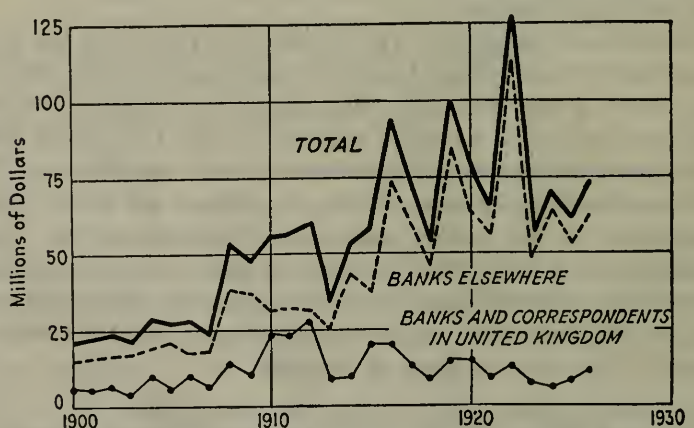
[208] See p. 537 of *Minutes of Proceedings, Evidence, etc.*, 1913.

[209] Source of data: *Returns of the Chartered Banks*. Data as of last banking day in July each year.



CURRENCY HOLDINGS OF THE CHARTERED BANKS

CALL LOANS. Since there is no money market in Canada [210] the banks there rely on the money markets in London and New York, but principally upon the latter's call loan and acceptance markets. The fact that rates in the New York call loan market



VOLUME OF THE FUNDS OF THE CHARTERED BANKS PLACED ON DEPOSIT WITH FOREIGN BANKS

210 See *Interviews on the Banking and Currency Systems of Canada*, p. 127. See p. 291 of this chapter.

usually rule above rates on call in London and that gold shipments may be made more quickly and easily from there to Canada are among the reasons accounting for the practice of holding the bulk of such loans in New York.[211] As would be expected the call loans of the Canadian banks exhibit seasonal fluctuations corresponding roughly to the seasonal credit requirements of agriculture. The following index of seasonal variation was based on monthly data from 1913 to 1926:

Adjusted Index of Seasonal Variation of Call and Short Loans Elsewhere than in Canada

Month	Index	Month	Index
Jan.	94.8	July	99.4
Feb.	100.9	Aug.	98.3
Mch.	101.9	Sept.	97.4
Apr.	103.0	Oct.	95.4
May	104.2	Nov.	103.2
June	103.6	Dec.	97.9

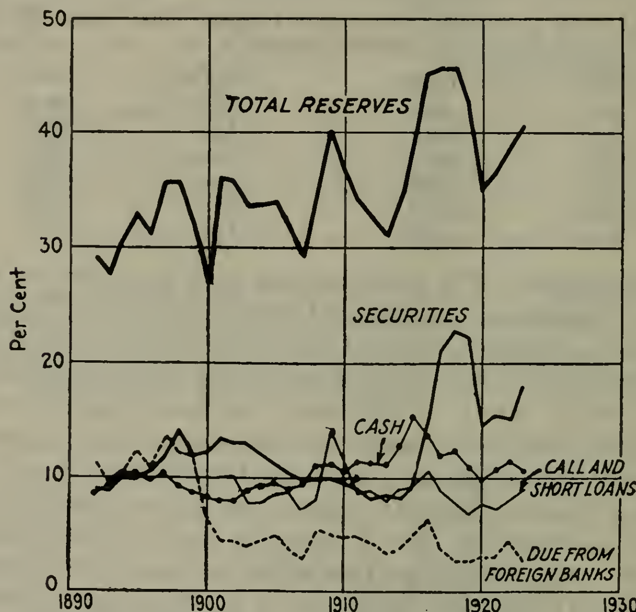
INVESTMENTS. The fourth earning asset considered as a reserve is investments in bonds and commercial paper. The practice of the chartered banks of considering bonds as reserve has been criticized on the score that these could not be readily sold in case of need. For at a time when they most urgently require funds, the bond market might be depressed at home and abroad. Particularly was such the case in the United States prior to the Reserve System when that country was visited periodically by panics rendering the sale of American bonds virtually impossible.[212] This condition has been remedied through the stabilizing influence of the Reserve System which has given greater security to the bond market and made bonds more readily salable or shiftable. As shown in the chart on p. 427 the bond holdings of the chartered banks declined only slightly in the years of depression between 1907 and 1908. On the other hand, from 1919–1920, there was a greater decline consisting largely of sales of Dominion and Provincial Government securities and Canadian municipals and repayments of short-term Treasury Bills. By way of summary, bonds do not constitute a particularly good secondary reserve, they are apt to be purchased when bond prices are high, i.e., when interest rates are low, when there is a limited commercial demand

[211] For the amount of call loans, see pp. 415–418.

[212] *Ibid.*, p. 165.

for funds, and sold when bond prices are low, when interest rates are high, and when there is an intense demand for funds on the part of trade and business.[213]

The following chart gives the per cent fluctuations in the various "reserves" held by the chartered banks. The amount due from foreign banks is not as large relatively as in the nineties, securities are much larger, cash somewhat larger, and call and short loans about the same.[214]



Reserves as a Per Cent of Net Liabilities

Reserve Policy. The reserve policy followed by the chartered banks was outlined by Sir John Aird, General Manager of the Canadian Bank of Commerce, in his testimony in 1923, which is inserted as typifying more or less the official attitude of the banks: [215]

[213] In this connection see p. 97 of *Interviews on the Banking and Currency Systems of Canada.*

[214] Source of data: *The Canada Year Book,* 1924, p. 804.

[215] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 348.

Q. In that connection what percentage of your deposits does the bank keep on hand for present emergencies? — A. We have fifty per cent, — we think fifty per cent is a safe percentage and then we have our liquid reserves. In liquid reserves the first line of defense is your gold and legal tender; your second line of defense is your security in the way of Government bonds, provincial and municipal that you can sell on the market; your third which might possibly be made the second and the one which I have made second may be made third, are call loans in Toronto, Montreal, New York and London. A bank that is on a safe basis should have anywhere from 40 to 60 per cent of this class of securities and cash. We think 50 per cent is fair. The Bank of Montreal have a little larger, being the Government bank; they have that percentage.

With regard to the same problem Sir Edmund Walker testified: [216]

Q. Can you tell me if any proportion of a bank's reserves are idle during the year? What proportion of reserves must you keep immediately available? — A. Well, we keep about from ten per cent to twelve per cent in actual cash; twenty to thirty per cent in quick loans, and forty to fifty per cent reasonably quickly got at. Not more than forty or fifty per cent of our money is lent out on time.

In times of crises several methods are open to the Canadian banks desirous of improving their cash position. They may withdraw their call loans or deposits from abroad, may sell or borrow on their securities, and since 1914 have been able to borrow from the Government. Another method followed is that of selling commercial paper to note brokers, which was described by Mr. H. O. Powell, General Manager of the Weyburn Security Bank in the 1923 hearings.[217] Another policy the banks follow during crises to improve their cash position is that of instructing the managers in the larger centers to keep their loans well in hand and not to make further commitments. The loans in smaller places are left pretty much undisturbed.[218] Through adopting one or more

[216] *Ibid.*, 1923, p. 574.
[217] *Ibid.*, 1923, p. 405.
[218] *Interviews on the Banking and Currency Systems of Canada*, p. 175.

of these methods, the chartered banks have been able to weather successfully the crises through which the Dominion has passed. The record of her neighbor to the South is not nearly so satisfactory, for the United States prior to 1914 regularly suspended cash payments at times of crises though her per capita gold holdings were among the largest of any nation.[219]

Audits, Examinations, and Returns. One of the distinguishing characteristics of banking in the United States is the periodic governmental examinations and inspections. These, in the case of National Banks, are expected to be made at least twice a year. In the case of many states, examinations are made as frequently and standards are quite as high if not superior. Even so it must be admitted, that in many states the examination staff is undermanned and poorly paid, and the character of the work poor. Not only do the Comptroller of the Currency and state banking departments have the duty of examining banks under their control, but the Federal Reserve Banks may examine member banks and many clearing houses, since 1907 when the panic of that year revealed glaring weaknesses in bank policies, have also assumed this obligation. As a matter of interest, a national bank in New York City, assuming it is a member of the clearing house, would be examined by representatives of the Comptroller of the Currency, of the Federal Reserve Bank of New York, of the clearing house, and if it happened to have a trust department, that could also be examined by the state banking department of New York. As has been so frequently stated in this chapter, the reason accounting for the many examinations and the mechanistic standards of technique to which bankers in the United States must adjust their operations is the unit type of banking system, banks operated by persons, who have gained a monetary success in other lines, who are not bankers by tradition, and who often have little concept of the public nature of their profession.

Until 1924, Government examination or inspection of banks did not exist in Canada though it had been advocated from time

[219] In one of his studies Prof. J. Courtland Elliott indicates that the ratio of cash reserves will be determined by:

(a) Structure of the banking system.
(b) Character of the liabilities.
(c) Availability of secondary reserves.
(d) The general economic situation.

to time. In consequence, however, of the failure of the Home Bank and of the scandalous nature of its operations, provisions were then inserted in the Act providing for the appointment of an Inspector-General of Banks.

Prior to the establishment of Government inspection, the Act required and in fact still does require an audit under the direction of the shareholders. The section requiring this had been inserted in the Act at the time of the 1913 revision as the result of the arousing of public opinion by several prior bank failures and of the crystallizing of this sentiment by Mr. McLeod. It was hoped by some that the shareholders' audit would detect mismanagement at the head office and so cut down the number of failures. But the provision did not measure up to the anticipations of the public, and in consequence of the debacle of the Merchants Bank, it was rewritten and greatly strengthened in the 1923 revision.

In addition to the examinations conducted by the Inspector-General and by the shareholders' auditors, the branches are examined by a staff of inspectors, sent out by the head office, who unannounced visit each branch at least once a year. Upon their arrival the inspectors immediately count the cash on hand, balance the books, and verify every item appearing on the balance sheet.[220] A detailed report on every loan is made which is transmitted to the head office along with the chief inspector's impressions of the management of the branch. In his testimony before the Banking and Commerce Committee in 1923, Sir Edmund Walker declared that it took the entire time of fifty highly trained and competent men to make the internal inspection of the Canadian Bank of Commerce.[221]

THE STRUGGLE FOR THE SHAREHOLDERS' AUDIT. Before and during the hearings on the revision of the Bank Act in 1913, the chartered banks, aside from the Bank of Nova Scotia, vigorously opposed any form of external inspection and in fact rather reluctantly accepted the audit provisions more as an escape from outside examinations than by reason of any faith held. The Bank

220 For an account of this system, see *Minutes of Proceedings, Evidence, etc.*, 1913, p. 240.

221 See p. 516. In 1912 the Bank of Commerce spent $102,762, for the examination of its branches. *The American Economic Review*, 1913, p. 994.

of Nova Scotia, itself, under the farsighted leadership of its General-Manager, Mr. H. C. McLeod, was a pioneer in advocacy of bank examination. In an address before the shareholders in 1910, he indicated he was not satisfied with the then existing banking conditions, that external inspection was needed, but would probably not be adopted in as much as all members of The Canadian Bankers' Association were most emphatically opposed.[222] The attitude of the bankers at that time was expressed in the testimony of Sir Edmund Walker in 1913, who declared that every nook and cranny of the bank was inspected by its own staff and that he did not believe in Government inspection, that it would not be useful, and he indicated that it had not been effective in the United States.[223]

This lethargic attitude was confined mainly to the banking community for the ideas advanced in favor of external inspection had found some acceptance among the public and by their parliamentary representatives. In response to this widely prevailing feeling the Government cabled Mr. McLeod, who, in the meantime, had retired from the Bank of Nova Scotia and was in Italy, to return and to present his views before the Committee on Banking and Commerce to assist it with the drafting of the 1913 revision. Upon returning he testified that the Finance Department had failed " to exercise effective control over the banks " and that the Government was extremely reluctant to assume any responsibility lest this should be interpreted as an assumption of liabilities in the event of insolvency.[224] He suggested that the Finance Department might establish a bureau or Board of Bank Inspectors selected by the General Managers.[225] He criticized the proposals for a shareholders' audit contained in preliminary drafts of the Bank Act for not carefully stipulating the qualifications of the auditors, and for opening the way for the appointment of

[222] See p. 23. *Seventy-Eighth Annual Report,* Bank of Nova Scotia. In 1913, Mr. McLeod declared he had been an advocate of bank inspection for nearly twenty years, that The Bankers' Association had been unanimously opposed to such proposals and that at some meetings he could not get a hearing. *Minutes of Proceedings, Evidence, etc.,* 1913, pp. 144–145. Mr. McLeod, "to practice what he preached," had had the Bank of Nova Scotia audited by chartered accountants from Scotland.

[223] *Minutes of Proceedings, Evidence, etc.,* 1913, p. 500.

[224] *Ibid.,* 1913, p. 108.

[225] *Ibid.,* 1913, p. 110.

auditors who would be " dummies " of the General Manager. The inspectors should, he declared, examine each bank at least once a year, which inspection might possibly be confined simply to the head office.[226] While he admitted that external inspection could not by itself prevent all bank failures, yet it would have prevented such a bank as the Ontario from continuing in an insolvent condition for 25 years and the Farmers' Bank from being established when everyone knew that, from its very inception, the bank was unsound and would ultimately fail.[227]

The provisions as drafted did not provide for external inspection but required instead a shareholders' audit without taking sufficient care to guarantee the proper qualification of the auditors.

Revision of Audit Provisions in 1923. The circumstances surrounding the debacle of the Merchants Bank led to a thoroughgoing revision of the shareholders' audit provisions in 1923. It had developed that the auditors had not made a careful valuation of the securities, loans, mortgages and hypothecs,[228] and the only explanation of the auditors' failure (the auditors were two partners in the same firm) was that through long associations with the bank they had lost a proper perspective.[229] The feeling was general that thoroughgoing changes were necessary to prevent a repetition of such conditions. In the redrafting of the audit provisions, the proposals and amendments suggested by Mr. George Edwards were largely followed.[230]

The rather obviously necessary provision was added to the Act stipulating that the auditors selected must be experienced and belong to an incorporated association of accountants. The wisdom of this provision was borne out later when it was revealed that the Home Bank had not been audited by a man who was either an accountant or who had had experience.[231]

Then, in the second place, it was provided that the audit should be made by two persons, not members of the same firm, one of

[226] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 142.
[227] *Ibid.*, 1913, p. 142.
[228] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1924, p. 25.
[229] *Ibid.*, 1923, p. 760.
[230] *Ibid.*, pp. 735–739.
[231] *Ibid.*, 1924, p. 383.

whom should be replaced by another auditor after two years of service. The advantages from such an arrangement were described by Mr. George Edwards, a chartered accountant, in the following terms:[232]

> A further consideration of much value would be that an auditor might be replaced without exciting public alarm. Even under the proposal in the Bill that there shall be two auditors for a bank, each independent of the other, a proposal to refuse to one of them the reappointment he looks for might be a very dangerous thing. The periodical retirement of an auditor, under the statute, would obviate all these risks and afford corroborative evidence to the shareholders that their investment was sound.

Another important change consisted in making more definite and inclusive the certificate which the auditors must sign upon completing their examination. So definite and precise was this that the auditors could not possibly plead any excuse for neglect to understand the full and true position of a bank.[233]

A provision which occasioned a considerable amount of comment and discussion was that prohibiting an auditor from accepting any retainer or undertaking any employment on behalf of or at the instance of the bank whose accounts and operations were being scrutinized. Sir Edmund Walker had opposed this provision on the ground that the usefulness of the auditors would be largely defeated and to know intimately the condition of the bank that they should be allowed to audit subsidiary realty companies or the affairs of large customers.[234] A chartered accountant, Mr. G. T. Clarkson, asserted that the adoption of this clause would compel his firm to withdraw from the field of bank auditing.[235] It required, he said, a staff of twenty-five competent and highly trained men a considerable amount of time to undertake a bank audit, which was a heavy piece of work and the direct remuneration was so small that unless his firm were permitted to

[232] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 760.

[233] *Ibid.,* 1924, pp. 7 and 42.

[234] *Ibid.,* 1923, p. 519.

[235] *Ibid.,* 1923, pp. 725–728.

engage in other work on behalf of the bank that it would be compelled to take this action. Mr. George Edwards defended the provision on grounds of professional ethics, and explained that while an auditor could not carry on special work for the particular bank whose affairs he was auditing this disability did not of course apply to the other chartered banks.[236]

Another change required the auditors to report to the General-Manager and to the directors of the bank, whose business was being scrutinized, each loan in excess of 1% of the paid-up capital of the bank which seemed inadequately secured and in general upon any transactions which appeared unsatisfactory. As explained by Mr. Edwards, the advantage of this was that it obliged the auditors to follow closely and continuously the affairs of the bank: [237]

Subsection 10 is a clause which is a very great advance upon the previous Act, inasmuch as it obligates the auditors to follow the course of business from time to time throughout the year. The previous audit clause permitted an auditor to attend twice a year for certain purposes, and if he satisfied himself once a year under the terms of the Act as it then stood, he had performed his duty; but under the present Act, an auditor has not performed his duty when he goes that far; he must go farther, and must examine the credits and the securities and report to the directors from time to time. Each auditor is responsible for doing that, and each auditor is responsible for informing each of the directors in writing in the way prescribed by the Act as to the condition of those credits and anything respecting them with which he is not fully satisfied.

Government Inspection. The suspension of the Home Bank on August 17, 1923, which followed closely upon the 1923 revision, was the immediate cause of the amendment assented to on July 19, 1924, which provided for the examination of the chartered banks by the Government. Government inspection had received wide publicity through its advocacy on the part of Mr. H.

[236] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 765.
[237] *Ibid.,* 1924, p. 7.

C. McLeod in the first decade of the century. As stated above, he vigorously argued in favor of this before meetings of the Bankers' Association and before the House of Commons Committee in 1913. The bankers were unalterably opposed then and again in 1923 when the question was once more discussed. Thus Sir John Aird stated before the Committee that the Government did not have the ability, the efficiency, or the means to examine banks and that it would assume a responsibility in so doing of protecting the depositors against loss.[238] As an illustration of the hostility of the bankers, in a pamphlet entitled "Banks and Banking" issued by the Canadian Bankers' Association in 1923, several pages were devoted in an effort to convince the public of the impossibility of Government inspection.[239] In its annual report for November 30, 1923,[240] the Canadian Bank of Commerce stated that government inspection in other countries did not impress it favorably and that in the United States it had become a "factor imperilling the successful future of the National banking system." In this whole question the bankers took a purely negative attitude and in the opinion of *The Monetary Times*[241] lost a great opportunity to "suggest a workable scheme of government inspection, which would really inspect, and at the same time not interfere with the free working of banking operations." The government of the day was itself opposed, feeling that adequate protection was given the public by the redrafted audit provisions and that it was not wise to go further.[242]

The opposition to Government inspection vanished in thin air following the failure of the Home Bank. From that time on there was no argument over the merits of inspection. The discussion centered around the methods to be followed and the provisions to be drafted. Upon the convening of Parliament, the Select Standing Committee on Banking and Commerce was directed by a resolution passed on March 31, 1924, to make

[238] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, pp. 378–379.

[239] See pp. 9–13.

[240] See pp. 34–35.

[241] 1924, p. 3.

[242] See speech of the Hon. Mr. Fielding, *House of Commons Debates,* June 19, 1923, pp. 4088–4090.

recommendations which would prevent such occurrences as the Home Bank episode in the future: [243]

"That in the opinion of this House, in view of the failure of the Home Bank and of the fact that official prosecutions and inquiries have been instituted, including the Royal Commission which has been appointed to investigate the facts alleged in the petition represented by the depositors of the Bank and the affairs of the Bank generally; and considering that the evidence received and to be taken before the several tribunals will be available for consideration, the Select Standing Committee on Banking and Commerce should be instructed to consider the provisions of the Bank Act with a view to recommending such amendments to the Act as will better protect the interests of depositors generally and will prevent similar occurrences in the future; and also to consider the report of the Royal Commission in its bearing upon these matters and with respect to the possibility of saving the Home Bank depositors from loss," be referred to the Select Standing Committee on Banking and Commerce for such action as the Committee may deem advisable.

The Committee held hearings from May 13 to June 12 in the course of which some ten witnesses testified, including among others Mr. George Edwards, chartered accountant; Mr. George D. Finlayson, Superintendent of Insurance at Ottawa who had charge of the examinations of loan and trust companies incorporated under the laws of the Dominion; Mr. C. E. Neill, then acting-President, Canadian Bankers' Association; Mr. Henry T. Ross, Secretary, Canadian Bankers' Association; Mr. J. C. Saunders, Deputy Minister of Finance; Dr. H. M. Tory, President of Alberta University; Mr. John W. Pole, Chief National Bank examiner, Washington, D. C.; and Mr. J. Skelton Williams, a former Comptroller of the Currency of the United States.

A question which arose immediately was whether the Government examiner could conceivably become sufficiently and thoroughly acquainted with an institution having hundreds of branches widely separated. Mr. George Edwards felt confident that a

243 *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. VI.

person by inspecting the head office and principal branches and by examining the reports sent in by the branch managers, the bank's own inspectors and the shareholders' auditors could readily form an opinion regarding the management and position of a bank.[244]

A strong argument in favor of Government inspection, largely of a psychological nature, and one which had much weight, arose from the fact that the Minister of Finance under the old provisions would not order a special examination excepting under the most extreme circumstances for to do so would cast grave suspicion upon the bank and, in order to eliminate the spectacular, the examinations should be made periodic and a matter of routine.[245]

On June 5, Mr. Robb, then the Acting Minister of Finance, outlined the main features of the system of inspection sponsored by the Government.[246] These formed the basis of a new Section, 56, of the Bank Act which was assented to on the 19th. It was provided that the Governor-in-Council, upon the recommendation of the Minister of Finance and Receiver General, was to appoint the Inspector General of Banks who was to hold office during good behavior. The Inspector, not less than once a year, was to make or cause to be made such examination or inquiry into the affairs of each bank as he deemed necessary or expedient, to ascertain whether the provisions of the Bank Act were being observed and whether the bank was in a sound financial condition. Should the inspector be convinced that a bank is insolvent he is to report such information to the Minister of Finance and Receiver General who might, without waiting for the bank to suspend, request The Canadian Bankers' Association or the President thereof to appoint a curator to supervise its affairs. The expenses incurred were to be paid from the Consolidated Revenue Fund and recouped after the end of each calendar year by an assessment upon the banks based upon their average assets through the year. In October, 1924, Mr. C. S. Tompkins, formerly associated with the Royal Bank, was appointed as Inspector General.

[244] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, pp. 19, 26, 31 and 49.
[245] *Ibid.,* p. 251.
[246] *Ibid.,* p. 299.

Returns of the Chartered Banks. By section 54 of the Bank Act the chartered banks must transmit monthly to the Minister of Finance, in a form prescribed by the Act, their financial statements. Amendments to this section were adopted in 1923 which called for more precise and complete information. The assets are grouped into some 30 categories and the liabilities into 17. Such pertinent information is given as the aggregate amount of loans to directors and firms of which they are partners and loans for which they are guarantors; the amount of non-current loans; of shares of, and loans to, controlled companies; of the greatest amount of bank notes in circulation during the month; etc. These returns are among the most complete and detailed required by any government and are a mine of information. The United States could well take a leaf from Canadian experience and require monthly returns from all national banks which information could be used to supplement that given in the weekly returns of the reporting member banks of the Federal Reserve System.

Controlled Companies. By a provision inserted at the time of the 1923 revision, the chartered banks must report the assets and liabilities and the interest of the Bank therein of each controlled company through which it conducts any of its operations. Several of the banks have subsidiary realty companies which build, borrow thereon, control and operate the property in which the bank has its offices. Such a company may be formed to take over the real estate acquired by a bank in the settlement of an obligation and which it must dispose of by the provisions of the Act. The Royal Bank owns the Globe Realty Co., Ltd., and the Royal Bank of Canada, France. The Bank of Montreal has four subsidiary companies and the Canadian Bank of Commerce has five.[247]

The Bankers' Association. By section 124 of the Bank Act, there have been delegated powers and administrative duties to The Canadian Bankers' Association, an incorporated organization, unknown to any similar association in the world. The origin of this unique body has been sketched by Sir Edmund Walker in a booklet entitled " Canadian Banking "[248] which reveals that some

[247] The realty company idea was introduced into Canada by the Bank of Commerce in 1907.

[248] See pp. 31–32.

of the bankers following the revision of 1891 felt it would be to their mutual interest to organize an association similar to the ones existing in England and the United States. The announced purposes of the new organization were those of watching legislation, court decisions and of guarding the interests of the chartered banks. In the next revision an incorporated body (at the request, so it is asserted, of the Government) was created by the Act to replace this voluntary organization and was granted quite definite powers:

(1) To establish sub-sections of the Association. One, for example, has been organized at Winnipeg and another in Vancouver.
(2) To appoint a curator for a bank which suspends payment and to supervise its affairs until the resumption of its business or until a liquidator is appointed.
(3) To establish clearing houses whose by-laws must be approved by the Treasury Board.
(4) To supervise the printing, delivery and destruction of bank notes and to inspect the circulation accounts of the individual banks.[249]
(5) To supervise the custody and management of the Central Gold Reserves.[250]
(6) To impose penalties for the breach or non-observance of any by-law, rule, or regulation (adopted by approval of two-thirds in number of the banks, provided that such banks have at least two-thirds in par value of the paid-up capital) made by virtue of this Section of the act, all such by-laws, rules or regulations being subject to the approval of the Treasury Board.

The Bankers' Association, whose establishment was largely the work of Sir Edmund Walker, naturally takes a most active interest in the revisions of the Bank Act. During the discussions leading to the revision of 1923, several pamphlets were issued designed to enlighten public opinion regarding banks and banking

[249] For a detailed account of this, see the testimony of Mr. Henry T. Ross before the Committee on Banking and Commerce in 1924, pp. 317–318.
[250] See pp. 385–387.

problems, but which were chiefly concerned in arguing the maintenance of the *status quo* in legislation. Like many associations of bankers its stand on legislation is ordinarily not constructive but rather negative in an advocacy of "letting well enough alone." For example, the association opposed vigorously the introduction of the audit and inspection provisions in the Bank Act. Indeed it is noteworthy that the various changes strengthening and improving the act have had their initiation outside of, rather than from within, The Canadian Bankers' Association, dominated as it has been by the larger banks.[251] It is true that in its supervisory functions it has rendered worth while services and that its *Journal* is a distinct contribution to banking literature.

CANADIAN BANKS AND THE ECONOMIC DEVELOPMENT OF THE DOMINION

The responsibility of a banking system for a nation's economic development and ascendency is impossible to measure exactly or to express in really satisfying quantitative terms, and particularly is this true in evaluating the contributions of one type of banking system as contrasted with another. That the modern state needs efficient credit institutions is but axiomatic, just as it needs good railroads, harbors, etc., for the furtherance of trade and produc-

[251] See pp. 138–139 of *Minutes of Proceedings, Evidence, etc.,* 1913.

Relative to this statement, Mr. Henry T. Ross wrote as follows: "The further statement that the Association has contributed virtually nothing towards the strengthening and improving of the Act also requires modification. Sir Edmund Walker, at revisions of The Bank Act since 1881 (after 1890 appearing on each occasion as one of the representatives of the Association) was recognized by successive parliamentary committees as contributing in a material way, by reason of his knowledge of the practice and science of banking, to improvements in the Act. Several of the improvements in the amendments of 1923, and the inspection provisions of 1924 emanated from representatives of the Association. As to the assertion that its (the Association's) advice to the Government has almost without exception been of a negative character, in addition to the constructive work done in the several revisions of The Bank Act by the Association's representation, successive Ministers of Finance have acknowledged the valuable advice and assistance given by the Association on various occasions, particularly in regard to the financial legislation incident to the Great War, and the assistance which the Association rendered in various directions at that time."

tion. That is all assumed. Our problem rather is that of estimating the contributions of the particular type of banking system existing in Canada to the economic growth and stability of the country, especially as contrasted with the services which might have been rendered by a unit independent type of banking system if such existed.

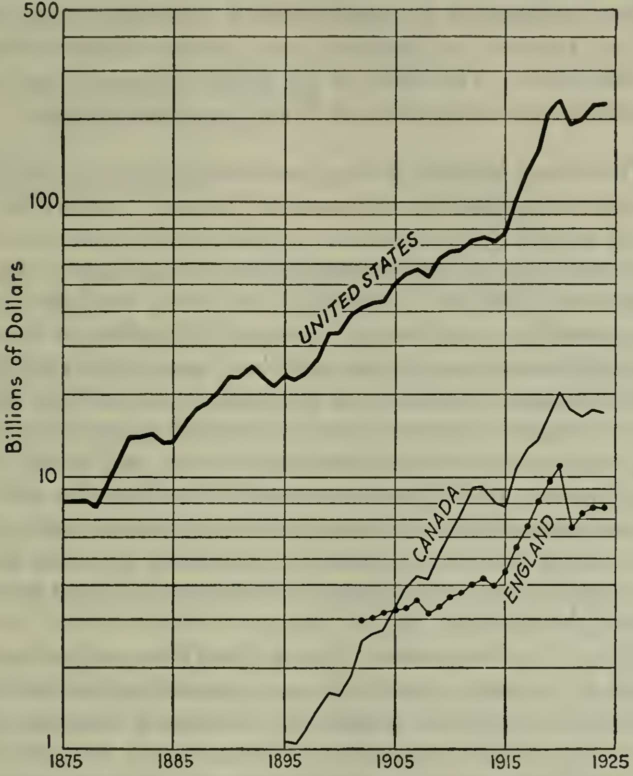
Canada's Ascendency. To the opponents of branch banking in any form in the United States, and especially to the " die-hards," Canada is pictured as a part of the Arctic wilderness whose people are subservient to the all-powerful and grasping branch banks. The statistical data available belie all statements as to the economic serfdom of the Canadians and reveal them as having enjoyed unexampled prosperity. Thus in a recent study by Drs. Thorp and Mitchell, Canada leads seventeen countries in the number of years of prosperity per year of depression. For the period from 1888–1924 Canada has had 1.86 years of prosperity for each year of depression while the United States has enjoyed but 1.79 years and the average for the seventeen countries is but 1.14 years.[252] Canada's remarkable and phenomenal growth in economic power is also portrayed in the ratio chart on page 449 which compares annual bank clearings in the United States, Canada, and England. The percentage growth in the case of Canada (in spite of the effect of mergers and amalgamations on clearings) far exceeds that of the other two countries.

Relation of Canadian Prosperity to Branch Banking. Statistical analyses establish beyond any reasonable doubt the extent and degree of Canada's economic development, growth and prosperity, the nation which leads all others in the number of years of prosperity. Either because or in spite of her banking system, she has achieved this, and the evidence indicates that her banking system has played an important part. Not the only part, for the railroads, the land and immigration policy of the Government have all had a share.

The statement just made that her banking system is in part responsible and has accomplished more than could an independent unit-type was corroborated by replies received to a questionnaire sent by the writer to a number of Canadian economists.

[252] Thorp, Willard Long and Mitchell, Wesley C., *Business Annals*. New York: National Bureau of Economic Research, Inc., 1926. p. 65.

One answered that there is little doubt that branch banking has helped materially and is still doing so in the progress of the country and especially in the rapidly expanding sections. The branches frequently do not pay for at least three years. With a system of local banks the newly settled territories would not get



Annual Bank Clearings in the United States (Excluding New York), in Canada and in England (Excluding London). Pounds Converted to Dollars at Annual Average Rates of Exchange

the banking facilities, which they need, so quickly or so efficiently. Another replied in much the same fashion emphasizing the banks' contributions to the Middle and Western Provinces. However, he added that there might be some justification for claiming that funds have been drawn off from the Maritime Provinces, these

" dead ends " of the Dominion, to reap the larger profits of the newer and more progressive sections. The third doubted, and he was the only one taking this position, whether branch banking had contributed *directly* to economic progress in Canada. Economic progress, he asserted, would have been quite as pronounced under a unit system and, furthermore, the system of branches had made possible, he declared, a centralization in banking, banking facilities, and business organization, to a greater degree in Canada than elsewhere. The reply of the fourth economist, which was somewhat more comprehensive than the others, follows:

" The branch banking system has decidedly been a contributing factor in the economic development of Canada. In the first place, because of the large amount of capital at the command of the banks, owing to the requirements under the Bank Act; secondly, owing to the fact that the manager of even a small branch can look forward to a professional career of distinction, as the larger opportunities are open to men who have proved their eligibility, and this brings a superior type of man into the banking field; in the third place, because the head office is advised promptly of local opportunities for economic expansion; and in the fourth place, because ample funds are usually available to meet that need and opportunity. Moreover, the large capital makes possible a certain amount of " financial " banking, in which aid has been extended to the promotion of railroads, pulp and paper industries, the fisheries, etc.

" Before the establishment of the Federal Reserve System, in my opinion, it was impossible for the average local bank in the United States to give the same support, or *direction*, to business expansion as was possible in Canada. The local bank was affected by local conditions, and had limited local capital. Under the branch banking system capital can be quickly mobilized and applied to aid communities ' on the frontier of business ' where opportunity as well as needs are often greatest.

" I find that local deposits in the West are exceeded by local loans. I have personally examined bank ledgers, and found instances of loans to farmers for three, four and even six thousand dollars, extending over a period of years. No one can say that this is desirable in the case of commercial banks; but at the same

time I believe it to be a fact that under the Canadian system no such pressure was placed upon farmers to compel liquidation as was experienced in the United States in 1920–1921."

Those qualities (not without their shortcomings) of the Canadian system, which are in fact the tests of any good banking system, and which have had their part in the nation's material advance are:

(1) Reasonableness of charges.
(2) Availability of credit.
(3) Safety.
(4) Control of credit.

REASONABLENESS OF CHARGES

Reasonableness of Charges. It is rather a difficult matter to obtain accurate data regarding the charges exacted for credit advances in Canada. There are no open money markets as in the United States or England. Foreign trade is financed either by way of New York or London and as business men customarily deal with only one bank there are no quoted rates on commercial paper. Facts regarding interest rates have to be gleaned from the proceedings of Parliamentary Committees and from the published reports of special investigators. From these, it would appear that there is a smaller spread between interest rates in the relatively developed and undeveloped sections of Canada than in corresponding sections in the United States. In the large centers, industrial districts and developed parts of Canada, the rates charged range from 5% to 7%, where in the comparatively recently settled sections, the Prairie Provinces, the rates range from 7% to 10% with 8% very commonly charged. Thus Sir John Aird testified that in Manitoba for the " gilt-edged " farmer the rates charged varied from 6% to 8%, with 8% as the prevailing rate for 95% of his bank's loans.[253] Mr. Beaudry Leman, in charge of one of the " French banks," declared that farmers in the East could borrow at from 6% to 7% and that loans in the West were extended at

[253] *Proceedings of the Select Standing Committee on Banking and Currency,* 1923, p. 361.

8% or 9%.[254] Professor McGibbon, in his carefully prepared report on banking conditions in Alberta, stated that current rates of interest on farmers' loans throughout the Province ruled at 8%, 9% and 10%.[255] His data were substantiated by replies received by a Mr. Spencer, a member of the House, to a questionnaire addressed by him to a large number of farmers, which indicated that the average rate ranged from 8% to 9% and that the usual length of agricultural loans was 3½ months, rather a short time for an industry having a turnover of only once a year.[256] In most instances he found the interest to be deducted in advance. Professor McGibbon indicated that this was a practice severely condemned by farmers in Alberta in that they liked to borrow round sums and that their rate of interest was increased through this practice.[257]

Still another point on which the farmers complained quite bitterly, and which we might introduce in this part of the chapter, while we are discussing the general subject of the technique involved in making loans, is the practice of some of the branches in lending funds for a period altogether too short for the purpose of the loan and then of compounding the interest on maturity. Thus a bank might grant a short-time loan due in midsummer which of necessity must be renewed until the harvest.[258] In compounding the interest the farmers feel the banks are guilty of sharp and usurious practices and when complaint is made, the bankers, so it is alleged, retort that farmers and other borrowers " are not forced " to borrow and when doing so must abide by the policy of the bank.

Returning once again to the subject of rates of interest, Mr. H. O. Powell, of the Weyburn Security Bank, whose bank operates only in Saskatchewan, declared that the majority of their loans bore 8% and that even 10% was charged to those who only borrowed and were not extensive depositors.[259] At another point he

[254] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 639.

[255] See p. 13. Mr. Henry T. Ross writes that two of the largest banks have for years charged no more than 8% in the Prairie Provinces.

[256] *House of Commons Debates,* June 18, 1923, pp. 4062–4063.

[257] See pp. 18 and 19.

[258] Professor McGibbon's report, pp. 4 and 22.

[259] *Minutes of Proceedings, Evidence, etc.,* 1913, pp. 424–425. See *Ibid.,*

stated, and with authority, for he had been engaged in banking in the States, that farmers in the Dakotas, directly across the Canadian border would be glad to obtain loans at 12% interest.[260] While the quantity of data available are not as complete as would be desirable, all evidence seems to bear out the view that interest rates are lower in Western Canada than in similar sections of the United States and that the borrower secures his accommodation at a reasonable cost.

Reason for Lower Interest Rates in Canada. The lower credit charges of the chartered banks, a real factor in the development of the West, arise from the ability of the banks to shift funds rapidly from East to West through the network of branches. A nation-wide mobility of funds is most vital in a country whose chief industries for some time to come will be those associated with the exploitation of natural resources. The farmer requires borrowed money principally over the growing season, and repays his banker in the fall. That money can be used to finance the lumber operator, who equips his camps in the fall and repays his banker later when his cut is driven down the rivers and sawn. The woolen goods manufacturer produces throughout the spring and summer months, but does not obtain the proceeds of his sales until the following winter. His financing dovetails with that of the cotton goods factory owner. The branch system administered by a central office furnishes the delicate mechanism which makes for the greatest economy in the available supply of funds. And the larger the bank (within limits of prudence and assuming the maintenance of an adequate ratio of net worth to liabilities), the more widespread its branches, the truer this is. The Bank of Nova Scotia, representing a conservative and sound institution, with branches in every Province may and can accomplish more for their customers than local banks or even one-Province banks. For if the one-Province banks operate simply in the West, they would not be as able to meet the borrowing needs of the community as would those institutions which shift the excess deposits of their Eastern branches West.[261] Then on

p. 542. The rate of discount is fixed usually at the head office, see *Interviews on the Banking and Currency Systems of Canada*, p. 175.

[260] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 432.

[261] See testimony of Mr. H. C. McLeod, 1913 hearings, p. 119.

the other hand, if the one-Province bank should operate exclusively in the developed and richer Provinces it would, of course, offer a safe depository for savings and could finance local needs but would, necessarily, play a minor rôle in the development of the West.

Then, again, as conditions change in a locality branch banks with nation-wide ramifications may rapidly readjust their policies. For example, in the 1913 hearings,[262] the case of a branch is cited which had been established in a particular locality for the purpose of making loans. After it had been in existence for about four years its loans amounted to $600,000 and its deposits to $150,000. As time went on and as the section became quite prosperous, deposits grew to $600,000, and loans fell to $150,000. In the early years of the life of this branch the community was financed, to an amount equal to four times its deposits by funds shifted from other parts of Canada. As the deposits of this branch increased in time, the head-office was enabled to use these elsewhere in lesser developed regions. In order to make data available on these points it is suggested that the Canadian banks should be required to *publish their deposits and loans by Provinces.*

The Question of Unit Banks. The question of permitting the establishment of small banks was raised in 1913 and again in 1923 and received considerable support. However ineffective or inefficient they are as compared with the branch banks they do have a strong psychological appeal. The borrower may speak directly to the head of the institution, whereas the branch managers must refer any question of moment to the district superintendent or head office. The proponents of unit banking not only emphasized this argument but also its implication, namely, that local banks take a real interest in the local community and become identified with its life more completely than a branch. And some of the proponents of local banks even declared that the large banks were octopus-like creatures sucking the earnings from local communities to speculate with these in Toronto and Mon-

[262] See p. 231. In this same connection it is interesting to note that 40 years ago the Bank of Nova Scotia had to seek an outlet for surplus funds in western grain and produce loans after the navigation season had closed in the Maritime Provinces. When the American banks were small three Canadian banks were important lenders in Chicago.

treal.[263] Some of the representatives in the House from the Maritime Provinces were most outspoken in favor of local banks though not necessarily unit banks. Twenty years ago, one speaker declared there had been fourteen banks with their head offices in those Provinces, the boards of which were composed of men who had lived there, who understood and sympathized with their difficulties and ambitions.[264] To-day not one chartered bank had its chief office in the Maritime Provinces. All large loans must be referred by local managers to the head office, where, a thousand miles away, persons pass on the loans who are unacquainted with the borrowers and even the country itself. Local enterprise is unable to secure sufficient funds and is stifled. But as Mr. Maclean, chairman of the Banking and Commerce Committee of 1923, pointed out, small banks could not compete in service and in reasonableness of charges with the larger institutions. If a small or local bank were assured of success it would have no difficulty in raising the necessary capital in the Maritime Provinces, in Halifax, or St. John. But local banks there could scarcely compete against nation-wide institutions. They could not offer the same rate of interest on savings accounts, since their own earnings would be low owing to the low local demand for loanable funds. The *borrowers* in the Maritime Provinces, it is true, would benefit from the establishment of local banks as their interest rates would be lower than that they would pay a national institution, for in the latter case they compete against borrowers in the undeveloped sections. But even so it would surely not be in the interest of the whole of Canada if interest rates were abnormally low in the Maritime Provinces and abnormally high in the West.[265] Better a leveling-up which would promote the development of the Western Provinces and so the general prosperity of Canada. The decline of the Maritime Provinces can not be ascribed entirely, as the proponents of local banks assert, to the branch banking system. It is due in the main to the better material opportunities in the West. These Provinces have not been able to compete against

[263] *House of Commons Debates,* 1913, p. 1928. Speech of Mr. Samuel Sharpe of North Ontario.

[264] See speech of Mr. Logan, *House of Commons Debates,* June 19, 1923, pp. 4078–4081.

[265] See testimony of Sir Edmund Walker, *Minutes of Proceedings, Evidence, etc.,* 1913, p. 532.

this Western lure, any more than parts of New England have been able to hold their population or industries (even with a unit banking system) against the call of the South and West. A banking system could not by itself and would not, if it could, ruin one particular section. Its decline, if such occurred, would be due to far more fundamental factors. Of course, in developing the West as a competitor and in the fact that rates of interest rule higher in the Maritime Provinces than would be true under a system of local banks, the banking system is in part responsible, but its culpability has consisted simply in the development and strengthening of the entire nation.

The argument that local banks or unit banks are more identified with and give greater support to local business than a branch system is double-edged. Local banks in the grain sections of the United States were so involved with local industry, with the land boom during the war and post-war inflation, all eggs had been so tightly packed in one basket, that these failed by the hundreds and thousands during the depression. In consequence many state banking superintendents are convinced, a feeling which is usually expressed mildly and hesitatingly, of branch banking as a solution. The Canadian branch banks not only can diversify the risk which local banks seem incapable of in heavy borrowing sections, but of even more importance they can and do stand behind their farmer customers. In this connection Sir John Aird declared that his bank had staked the farmers especially in Southern Alberta and Saskatchewan for one, two, three, and four years and had advanced them millions of dollars with the confident expectation that they would " come back." [266]

For a country such as Canada with a population scattered over vast stretches of territory, branch banks with their lessened overhead and costs of operation are par-excellence the best adapted to the needs of the country.[267] This fact was attested to by Mr. H. C. McLeod in 1913,[268] who asserted that the experience with local banks had been disastrous:

The experience of the country with such banks has been rather disastrous, they cannot compete with the branch banking system.

[266] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 361.

[267] *House of Commons Debates,* June 19, 1923, pp. 4078–4081.

[268] *Minutes of Proceedings, Evidence, etc.,* 1913, p. 112.

A branch of a bank will serve a community far better than any local bank can. In your local bank you have local directors, there are jealousies in every community, and borrowers will usually select the branch bank that has come in from outside in preference to going to the local bank, unless, of course, they have personal interests in the local bank. The local bank cannot compete in the matter of profit, and with the way banking is run to-day I do not think the local bank would exist at all.

Unit banks could not so adequately serve the interests of the country nor could they hope to compete successfully with the branch banks, no more indeed than the private bankers in Canada of a generation or more ago. Though only a one-Province bank, the Weyburn Security Bank survives and might seem an exception to our statement. But its shares are held by two or three persons who have to come to the assistance of the institution from time to time. The experience of the General-Manager peculiarly fits him for the territory in which the bank operates, but even so and in spite of a closely affiliated mortgage subsidiary it has had difficulty in earning its dividends.[269]

In concluding the discussion of unit v. branch banks, it might add strength to our argument to quote the opinions of two persons, impartial in their attitude and wholly conversant with the banking situation in Canada. The first is that of Professor Swanson, an economist in the Dominion.[270]

The local independent bank in the United States has done something for the community, because those who have their money in the bank and the directors are local men; but I do not believe that we are going to get the same results in Canada by establishing independent and local banks with small capital; we will only get those results when we have men, bankers, who identify themselves with the local community, who have some knowledge of agricultural conditions, whose main interest is in agriculture, who have a rural point of view as well as a financial point

[269] See speech of Mr. Maclean, *House of Commons Debates*, June 19, 1923, pp. 4078–4081.

[270] *Proceedings of the Select Standing Committee on Banking and Currency*, 1923, p. 778.

of view, remembering that it is not money that is going to save the West, it is money harnessed to labor power. What we require is to encourage the people who are laboring on the land to-day, and give them again that moral courage, the morale that was so important during the war for our men, and to restore that morale in the West, and you cannot do it with people that are discouraged, that are carrying a burden of debt too serious to support.

The second statement was that made by Mr. J. B. Forgan, who had been engaged in banking in Canada and at the time of the statement was a leading banker in Chicago. He was thoroughly acquainted with branch and unit banking and gave the following reasons for explaining his opposition to the establishment of unit banks in Canada: [271]

1. Because I believe experience in Canada as in England and elsewhere, has shown that small local banks cannot successfully compete where the more economical system of branch banking has been established.

2. Because competition among the large banks with branches affords the legitimate business of all localities better service than can be had from small local institutions.

3. Because small local banks are usually organized and controlled by local borrowing interests which leads to borrowers lending the bank's money to themselves and becoming the judges of the limits of their own credit, than which there is nothing more dangerous in the banking business.

4. Because small local banks, unless they are affiliated with large central banks, are at a disadvantage in the matter of carrying adequate cash reserves against their current liabilities.

Unit banks are not adapted to Canada's needs. She is fortunate in having a type of banking system that adequately serves her interests while on the contrary the United States struggles along with unit banks, unable to finance new sections adequately and apt to become dangerously involved with local life and industries. We do not mean to recommend for the United States the huge super-branch banks of Canada with their hundreds of branches,

[271] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 316. See also pp. 230 and 323.

with their low ratio of net worth and which might have a preference for the loans of large interests to those of small.[272] A golden mean must be struck between those on the one hand and the unit or even the one-Province banks on the other. This golden mean could be realized by allowing national banks with a specified capital and surplus to establish branches throughout the same Federal Reserve district as that in which the head office is located. This would prove of particular benefit to farmers in the Federal Reserve districts of Chicago, Kansas City and St. Louis, which possess a great diversity of economic interests and have ample funds for agricultural development.

[272] Regarding this statement Mr. Henry T. Ross wrote: The implication from this, of course, is that if large desirable loans are offering, the small borrower must suffer. In this connection let me quote Sir Frederick Williams-Taylor, General Manager of the Bank of Montreal, at the Annual Meeting of that Bank in December, 1921:

"I should like to take this opportunity of stating that we welcome small accounts at all of our offices."

Three years later, in 1924, he assured the small borrower in the following terms:

"I should like to emphasize that this Bank's services are at the disposal of every class of the population."

In addition, Mr. C. E. Neill, General Manager of The Royal Bank of Canada, in his address to the shareholders on January 10, 1924, stated:

"The funds which Canadian banks have available for agricultural and commercial loans are distributed to the best possible advantage in the general interest. To indicate how widely the loaning funds of this bank are distributed, I may say that we have no less than 65,000 direct borrowers in the Dominion of Canada, and that the average loan is only $4,080."

To show, further, that the statement in the sentence quoted is quite at variance with the facts, I have examined an Inspector's liability report of a large city branch of The Royal Bank of Canada, and there were 425 borrowing accounts for sums under $1,000. I saw one for as low as $26, and there were several scores for sums between that sum and $150. I have also been shown the Inspector's reports of country branches, two of which fairly illustrate several hundred of that Bank's branches in Canada. I give as illustrations:

(a)	Number of borrowing accounts,	200;
	Total loaned,	$122,000;
	Average loan,	$610.
(b)	Number of borrowing accounts,	252;
	Total loaned,	$300,000;
	Average loan,	$1,190.

The former was in a countryside in Saskatchewan; the latter in a village, with farmer customers chiefly, in Nova Scotia.

THE INTEREST CLAUSE OF THE BANK ACT. To revert to our discussion of interest rates in Canada, it will be remembered that interest rates in Western Canada are lower than in similar parts of the United States though higher than in Eastern Canada. This differential, a perfectly natural one, roused the ire of the Western representatives in the House of Commons along with the fact that the banks were charging rates higher than 7% which according to some was a violation of Clause I, Section 91 of the Bank Act. This clause reads as follows:

> The bank may stipulate for, take, reserve or exact any rate of interest or discount not exceeding seven per cent per annum and may receive and take in advance any such rate, but no higher rate of interest shall be recoverable by the bank.

As several witnesses appearing before the Banking and Commerce Committee pointed out, the Privy Council has ruled that this imposes no restriction on the rate charged, nor does it prohibit the rate from being collected in advance. Its only significance is in preventing a higher rate from being recoverable.[273] In the House of Commons at least two members [274] sought to introduce substitutes which would make effective the provision regarding the stipulated legal rate of interest, the one retaining the 7% rate and the other substituting 8%. Both proposals were negatived and the old clause remained. In his report, Professor McGibbon suggested that the maximum legal rate be fixed at 8% and that the law be made enforceable. It is not sufficient, he explained, to rely on competition alone to keep down rates of interest when it is realized that with branches of five of the chartered banks at Grande Prairie and of three at Peace River Crossing, interest rates continue to rule at 10 per cent. The only protection for the public is regulation. Eight per cent, as a maximum, he felt, would be fair to the banks and borrowers. It might prevent some loans from being made but if a loan is so risky that nothing but a 9% or 10% rate will warrant a bank engaging in such business, then, he concluded, the loans should not be granted. And

[273] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, pp. 531 and 971.

[274] Messrs. Shaw and Coate. *House of Commons Debates*, June 19, 1923, pp. 4105 and 4125.

in case the argument is raised that such a rate would deter a bank from entering a district, Professor McGibbon believed that this might not be an unfortunate result. In his Province, 117 branches of the chartered banks had been closed in the past ten years and it might not be undesirable if the banks were to make a more careful survey before establishing branches. The different discussions lead to no constructive action regarding this clause. One banker maintained that if interest rates were reduced to 7%, dividends would have to be cut to 3%, representing a loss of four or five hundred thousand dollars a year.[275] Moreover, he asserted, his institution would have to withdraw from a great many centers. Costs were high and profits so narrow that the branches could not be maintained.

Without exception the bankers who testified lay great emphasis on the higher costs in the West as the justification for the higher rates of interest. Thus Mr. Beaudry Leman, before the 1923 Committee,[276] indicated that salaries and living allowances were considerably higher in the West. Sir Edmund Walker cited the larger losses as justifying higher rates.[277] Mr. Garland, a member of the 1923 Committee, expressed the opinion vigorously that the higher costs resulted from the elaborate, ornate buildings erected by the banks on the Prairies, which saddled the community and shareholders with a heavy burden.[278] Professor Swanson, while not mentioning this argument did substantiate the bankers' statements that they would be forced to withdraw from the West if they were limited to 7% in their interest charges: [279]

In the West, of course, it would be a wonderful thing for the

[275] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, pp. 361–362.

[276] p. 637. See also 1913 hearings, p. 431, and for cost of living in Dawson during the gold rush and justifications for charging 2% a month interest, see 1913 hearings, p. 579. Before the same Committee Mr. Edson L. Pease claimed living costs were 25% greater in the West than in the East. (p. 543). See also p. 282.

[277] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 520. For same reasons mortgage credit was higher in the West, see *Proceedings of Special Committee on Agricultural Conditions*, p. 1135.

[278] *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 989. See also p. 399. In *Proceedings of Special Committee on Agricultural Conditions*, see p. 1133.

[279] *Proceedings of the Select Standing Committee on Banking and Com-*

farming community if they could get their money at seven per cent. They are not getting it. They are paying eight, nine, and ten. It would be a wonderful thing, but the point is, what would be the effect, and that is a very good question, your third question. Can the banks afford to do it? What would be the effect on banking in Western Canada? From the computations made by the banks in Western Canada, taking into account the risk of crop failures, of the loss of market, of the collapse of the market, and the like, we know perfectly well that seven per cent under present conditions would not pay the bank. I believe that some banks would withdraw; they would close their branches at various points. There is more to be said for a rate of eight per cent. But I think it is always a dangerous thing to state by law what shall be the price of anything; of the price of money; or even the price of what the farmer has to sell. We know that during the war, the price of what the farmer had to sell, namely, his wheat, was fixed, and undoubtedly the farmer could have got a higher price if the Government had not stepped in and set the price, which was the maximum price to the farmer. We ought to bear that in mind. I believe that when we can get competition among lenders as against competition among borrowers, such as obtains right now, when we can get more competition among lenders we will reduce the interest rate; and that can come only when we have done something else for agriculture; not only gone into this banking business, but gone into the question of the tariff, and of freight rates, and of widening the markets.

Even granting his point as regards the inadvisability of price-fixing, it would have been good psychology for the banks to have acceded to such a proposal as the 8% inforceable clause advocated by Professor McGibbon.[280]

While we are on the subject of bank costs, it may be of interest to insert at this point a table which appeared in Professor McGibbon's report of the profit and loss account of a country branch having the bare minimum of loans and deposits necessary

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merce, 1923, p. 786. Mr. H. C. McLeod made much the same statement as regards withdrawals in 1913, see p. 168 of the proceedings.

[280] Even so usury laws are difficult of enforcement with the bonuses, commissions of one sort and another and the necessity of maintaining proportionate free balances.

to be on a paying basis. The deposits amounted to $100,000 and the loans to $140,000 and the interesting feature of this statement is that the branch is expected to transmit to the head office an amount equal to 5% per annum of the amount by which loans exceed deposits:

PROFIT AND LOSS ACCOUNT — COUNTRY BRANCH

Having Average Savings Deposits of $50,000 and Average Free Balance of $50,000 in Current Account.

Salaries Manager .... $2,000 Teller-Act. ..... 1,200 Ledgerkeeper ... 800 Junior 500	$4,700[281]	Interest derived from loans of $140,000 at 8%	$11,200
		Inland and Foreign Exchange and discount...	700
Stationery	600		
Rent and Insurance......	900		
Taxes (Provincial and Municipal)	275		
Fuel and Light..........	225		
Postage and Express.....	300		
Telegraph and Telephone	100		
Sundries Advertising, traveling and relieving expenses, subscriptions, law costs, etc.	300		
Executive supervision....	500		
Annual charge for interest on capital outlay for fixtures, equipment, depreciation, installation and freight............	400		
Paid to Head Office 5% on $40,000, being amount by which loans exceeded the deposits of the branch............	2,000		
Interest paid on savings deposits at 3%........	1,500		
Profit	100		
	$11,900		$11,900

(It should be observed that in submitting these figures as an illustration covering operating costs, no provision whatever for losses enters into the computation.)

[281] The salaries do not total $4,700. This is copied exactly as it appeared in Professor McGibbon's report. It will be noted that no provision has been made for a cash reserve.

Bank Profits. To an American the average interest rates charged by the Canadian banks in the West, though they rule above the rate stipulated in Section 91, do not seem excessive. In a newly settled, rapidly developing territory, interest rates would naturally rule high, so intense the demand for present goods or the present uses of goods and so large the profits involved if circumstances are favorable. If the high interest rates were excessive or extortionate, this would normally be manifested in large profits and high rates of dividends. But as indicated by Mr. H. C. McLeod in 1913, bank profits are not excessive, and if indeed, bank profits were large, the banks would have no difficulty in increasing their capital to the heights demanded by prudence, a real problem facing them at the time.[282] The same opinion was expressed by Sir Edmund Walker, who indicated that few Western offices ever "pay" until the third year, that these initial losses are not usually offset until the branch has been in operation for six or seven years.[283] In fact he presented some statistics which showed that the profits of 100 industrial businesses in Canada were twice as large as those of the 19 chartered banks. In the following table a comparison is presented on a weighted average basis of the per cent of dividends to paid-up capital and surplus of the chartered banks and of national banks in the United States:[284]

Year	Chartered Banks	National Banks
1890	5.65%	6.1%
1895	5.18	5.0
1900	5.01	5.6
1905	4.76	6.1
1910	5.10	6.7
1915	5.20	6.3
1920	5.90	6.7

[282] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 108.

[283] *Ibid.*, p. 522.

[284] *Ibid.*, p. 521. See also p. 554. It has been asserted that the dividends in recent years have been larger than warranted as bank premises have not been written down as quickly as desirable nor have contingent reserves been built up.

With the exception of but one of these years the per cent dividends of national banks exceeded those of the chartered banks, and the average excess in the seven years amounted to .81 per cent. The interest rates in Western Canada, then, have not been the means of swelling the dividends of the banks. They are to be explained on the ground of the higher costs and larger losses. Of course, some assert, and probably with considerable justification, that these higher costs are due to competition between the banks in buildings altogether too fine for the community.

AVAILABILITY OF CREDITS

Another test of a good banking system, i.e., of one serving best the investment, commercial, and consumptive credit needs of a nation, is the availability of credit to those who are "deserving of credit," who have the requisite capital, capacity, and character. Thus a banking system which serves the industrialist to the exclusion of the agriculturist, or which makes it easier for a farmer to secure long-term credit than a city dweller is not efficient or playing the proper rôle in furthering capital needs, production and trade. Does the Canadian system make credit available on equal terms to producers and traders in all parts of the Dominion and does the credit system possess sufficient elasticity to expand and meet seasonal, cyclic and secular fluctuations, the dynamic changes in a nation's economic life? The Canadian system meets the dynamic fluctuations — in so far as these consist of seasonal or secular movements — quite adequately. And now that the banks may borrow from the Government under the Finance Act, the cyclic needs should be fully met. But it is when we speak of the static credit needs of industry, in so far as these may conceivably be separated from the dynamic, that we meet criticisms of the banking system. For example, borrowers in the Maritime Provinces have complained that they have not obtained the amount of credit necessary for their needs. Probably if Canada had a unit-type of banking system, those sections such as the Maritime Provinces which have normally an excess of deposits over loans, would be able to obtain larger amounts of credit at lower rates. But with branches scattered over the Dominion, the

borrowers in these surplus fund areas must compete with those in the "deficit" sections, where profits are larger and economic possibilities greater, so naturally they must pay higher rates. But even granting this, the banking system must not be held accountable for the economic decline of the Maritime Provinces any more than the British banking system could be held accountable for the decline of agriculture in England following the opening up and winning of the West in the United States. People have left the Maritime Provinces for a better living in the West and though interest rates may be slightly higher in the Maritime than they would be if there were a unit-type of banking system, rates are lower in the West, which is of more importance as a factor in Canada's development.

Another point involving this same issue of the availability of credit is that the large banks prefer large loans (which may be granted at a smaller relative cost), which has led to a concentration of industry in the larger centers of Canada. This it is alleged would not have occurred with a unit-type of banking organization. As measured by the value of products, the large manufacturing centers are Montreal, Toronto, Hamilton, Winnipeg, and Vancouver.[285] While industries in the United States are perhaps somewhat more widely scattered, the concentration in Canada (which is not as great as some would allege) is due not to the banking system, but rather to other factors such as accessibility to markets, labor, and raw materials. Each of these cities is on main railway routes and three have the benefits of water transportation. Montreal, the city of greatest manufacturing, is not far from the coal fields of Pennsylvania. Each has an ample supply of cheap labor which does not exist in the West. The momentum of an early start, the accessibility to markets, cheap labor, sources of raw materials, and transportation facilities have been the determining factors in the location of Canadian industry. Banks in this instance (even granting that large banks prefer large loans) have followed economic development rather than initiated it.

Branch Managers. A frequent criticism of the Canadian system which involves again the problem of the availability of credit and a comparison of the branch system with the unit type of

[285] *The Canada Year Book,* 1925, p. 432.

banking, is that branch managers are unsympathetic with local needs, that they are shifted about too frequently, often just as they are becoming acquainted with a particular section, and finally, that they are given little authority and must refer all questions to the head office. Such criticisms would almost invariably arise in a system where, for administrative purposes, authority must be more or less centralized. But as we shall endeavor to point out, these are errors of administration and not defects necessarily inherent in branch banking.

The first charge is that the branch managers, directed by policies formulated at the head office, are unsympathetic with the local needs and in fact withdraw support from a local community should it be in financial distress as, for instance, by reason of a crop failure when assistance is most urgently required. While instances undoubtedly might be cited of a lack of sympathy on the part of branch managers and of withdrawals of support, these are probably exceptional. The policy of the banks is to encourage the managers to take an interest in the community's social and economic life. The officials in the head offices know that any other policy would be suicidal. Where cases of "unsympathetic" managers are investigated, these are in most instances the outcome of the rapid expansion of branches through the West,[286] the necessity of training bankers quickly and of shifting managers about from places of lesser to those of greater importance. The expansion of banking offices in the West has been so rapid that problems of personnel could not have been properly met by any system. During the past several years when the banks have been reefing their sails, the personnel problem is no longer acute, and managers consequently remain long enough in one place to know and fully appreciate its needs. Not that a manager should remain permanently fixed, for that would be but to narrow his point of view and dampen his ambition. Some shifting is essential to promote the managers as their ability is demonstrated and to give them a truly national point of view. It is a really serious defect in the country banker in the United States that he possesses a strictly local point of view, unappreciative of national economic problems, and is really less able to advise his patrons than one who

[286] Incidentally an advantage not possessed by unit banks where considerable time is required for their establishment.

has served in the grain, lumber, fishing, and manufacturing sections of a nation and is thus able to correlate his patrons' needs and business with those of the whole country. A questionnaire was sent Canadian economists regarding this point and the consensus of opinion was that it is the policy of the bank to fully meet local needs, understand local conditions, and where this is not the case, it is due to defects of administration or the exigencies of a situation. The same thought was expressed in the bankers' testimony given in the 1923 hearings. Mr. Beaudry Leman asserted that a manager of a Western branch would be expected to know Western conditions and to serve as teller, accountant, and assistant manager before rising to the post of managership. It would be unusual to send a clerk from the East to assume charge of a Western office.[287]

To summarize, some of this " managerial " criticism grew out of the rapid expansion of the banks in the West and the personnel problems arising from the war. These as causes no longer exist. But included in Professor McGibbon's report [288] are certain criticisms which do not arise from temporary causes. One is that in instances where a branch manager has become too " liberal " in the granting of credits, he is shifted and the one who takes his place is instructed to " clean up " the district, a remedy which is disastrous for many borrowers misled, perhaps, by the too liberal policies of the previous manager. Another point is that little effort is made by the banks to fulfill the promises made by one manager to his clients when another takes his place. Thus a farmer may have been promised credit but, due to a change in management, he finds it is not forthcoming, leaving him to feel that the bank has broken faith. Professor McGibbon's careful study merits quoting on these various points, though their solution is by no means an easy one:

" There have been an extraordinary number of changes of managers in the branches of the chartered banks of this province in the last few years. According to information supplied me by the banks there are at the present date (August 10, 1922) three hundred and sixty-five branches in Alberta, five of which are sub-

[287] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 633. See Sir John Aird's testimony, p. 393.

[288] See pp. 29–31.

branches. Of the three hundred and sixty branch managers handling the business, sixty-two have been appointed to their present posts within the present year (1922). Seventy-nine were appointed in 1921, eighty-seven in 1920, sixty-four in 1919 and twenty-three in 1918. If we neglect 1918, over eighty per cent of the Alberta branch managers were post-war appointments. If we omit the figures for 1919 as adjustments particularly due to the war and consider only 1920, 1921, and part of the present year, two hundred and twenty-eight appointments or sixty-three per cent have been made within this period — of the total number of branch managers in Alberta, eighty-five or twenty-three per cent, and are in their first managerial position. The great bulk of these changes have taken place during the years of depression. It is clear that the farmer's feeling that the rate of managerial turnover is extremely high is fully warranted by the facts.

" The loss of personnel during the war has undoubtedly accelerated promotions, and each change usually causes others. Another cause of change has been the opening up of new branches in the West. In the five years between 1916 and 1921 over two hundred new branches were established in this Province, the majority of these in 1919. During the same period over fifty branches were closed. In 1919 it was stated that the banks had opened something like nine hundred new branches in the Western Provinces in a period of comparatively few years, ' which means nine hundred green managers to be tested — in some cases weeded out — and carefully trained. And it takes nearly as many years to make a good bank manager as it does to make a good farmer.' [289]

" Considerable evidence was presented to show that misunderstandings were frequently connected with a change in branch managers. It is quite obvious, I think, that dissatisfaction, arising from these misunderstandings, is increased when the change coincides with a period of depression. The new man is identified with the more careful policy of loaning that the change of conditions demands. The bank and its new managerial representative appear to be forcing credit restrictions on the community instead of changed conditions forcing a change of policy

[289] Mr. Vere Brown, of the Bank of Commerce.

upon the bank. Morever, I believe, there is a genuine loss in banking efficiency as well. A sound banker who knows a district of twelve or of fifteen hundred square miles is surely in a better position for a considerable time to carry on business than an equally sound banker who enters upon the field a stranger.[290] In so far as excessive changes in managers have arisen out of conditions that the banks themselves could not control — loss of personnel in the war and the exceptionally rapid expansion of the Western banking field — those causes have passed, and we may expect improvement.

". . . My impressions are that branch bank managers are being changed oftener than in the long run is good business. Moreover, I am inclined to think that the rapid expansion of the banks in western Canada has led to the appointment of a certain number of inefficient managers. For a while the results of such an appointment do not appear but ultimately the man is removed and the district lulled by easy credit into bad financial habits, endures a drastic clean-up with great irritation and in a certain number of cases with real hardship.

" Secondly, I think the banks are pushing the idea of changing managers to give young bankers varied experience to too great an extent. It should be possible largely to secure this varied experience before the status of manager is achieved. The effect upon the young bank manager tends to be bad. It leads him to take less interest in the permanent development of his district along sound lines, even though it may give him facility in the more mechanical aspects of estimating what is sound loan. He is part of a procession. As such there is a loss of efficiency during the period he is becoming acquainted with his district. Moreover, with his eye on the next post, he sometimes, I fancy, fails to know it at all. When his efficiency should be at its highest point he moves on and the experience has to be repeated. I consider it only too likely that the peripatetic country branch bank manager will have ultimately only a ready facility in rule-of-thumb banking. He will lack the higher kind of skill and sense of public service that in some countries have made country bankers the architects of their nation's progress.

290 The new branch manager may be greatly aided by adequate credit files.

"In the third place, if a bond of confidence that should exist between a banker and his client has been formed, it is broken and must be re-created. This necessarily takes time. Reading the record of a client's transactions with the branch may give a new manager some clue to the nature of his customer, but it is a poor substitute for personal knowledge. Moreover, the bond to be true and of value to each must be reciprocal. The customer has not the advantage of a study of the new manager's record. In uncertainty and doubt he must wait and learn by experience. When farmers think that young city bankers sent to be managers at rural points in order to gain experience look upon farmers as 'animals that have to be put into a corral at night and fed oat sheaves,' it takes time to remove such impressions. Moreover, with regard to complaints that verbal promises made by one bank manager have failed to be honored by the next, it is certainly true that changes lead to misunderstandings. This embitters the client of the bank who does not realize that the verbal promises of a branch banker afford him no certainty in a pinch."

Powers of Branch Managers. Still another complaint lodged against the administrative policy of the banks, which really has a twofold aspect mutually inconsistent, is that the branch manager possesses little discretionary power and on the other hand that he acts the czar in his locality.

Regarding the first point, the banks are now and have for some time followed a policy of decentralizing their operations as much as possible. Thus the Canadian Bank of Commerce has divided the country into several districts, Newfoundland (of course not a part of Canada), the Maritime Provinces, Quebec, Ontario, Alberta, British Columbia, and finally Manitoba and Saskatchewan which are each under one jurisdiction. In each of these divisions there is a Superintendent with power to pass on loans (in the case of Manitoba and Alberta) up to $75,000. For larger amounts the General Manager must be consulted, but his decision may be known in from 24 to 48 hours. The discretionary power of local managers would vary perhaps from $1,000 to $15,000 depending on his experience, ability and general importance of the branch. Then, too, a greater degree of decentralization and a better knowledge of local conditions is secured by the practice of

appointing local advisory boards.[291] With this system properly administered and with a proper selection of personnel, according to Professor Swanson, the branches should have that intimacy of knowledge and contact possessed by unit banks in the United States and with infinitely greater ability to assist their clients.[292]

Regarding the second part of this complaint that the managers act the czar, Professor McGibbon makes the point that they are really the courts of first and last resort. For they possess unqualified power in rejecting loans and the borrowers can not appeal to a higher authority,[293] and especially is this important in districts, some as large as 1800 square miles, where there is no competition. Little local money is available and if a borrower is refused, he is really " up against it." Furthermore, being the dispenser of credit, the manager may influence farming methods against the better judgment of the farmers themselves, might require them to engage in stock raising, and to diversify their crops, and the farmers, dependent on his good graces, would be afraid to cross his will even when the managers as in 1918 and 1919 " loaded " him with credit. These criticisms can be directed against any banking system, branch or unit, and really in the last analysis come down again to questions of personnel and administration which are capable of solution. To curb the czar-like proclivities of branch managers, Professor McGibbon suggests that a credit commissioner be appointed, before whom the farmers might lay their complaints, and who could report to the Provincial legislatures and banks. Another suggestion, made by Mr. Brown of the Bank of Commerce in his address to the United Farmers at Edmonton in 1919, was that local committees be appointed before whom farmers could lay their complaints and who would submit their reports to the banks: [294]

" But I can offer you a suggestion as to how the difficulty can be met. Supposing, when you go back to your homes, you appoint in your association a local Committee of Reference, so that

[291] *Proceedings of the Select Standing Committee on Banking and Currency*, 1923, pp. 392 and 451.

[292] *Ibid.*, pp. 795–796.

[293] Report, pp. 44–46.

[294] Quoted in Professor McGibbon's report, p. 47.

complaints of farmers in your own district might be put before it? Then if a complaint were made against a bank, that committee could sit down with the bank manager, sort out the statement of facts on both sides, and decide whether the bank was at fault. If the bank was found at fault and the manager was disinclined to recognize it, the local committee could pass their findings on to the Central Committee at Winnipeg, by whom the matter could be taken up with the chief representative of the bank there.

"Now, if as a result of such procedure, it were found that any one bank was not fulfilling its duty toward the farmers, the remedy would lie in your hands. On the other hand, if the fault was the fault of a local manager, here and there, no one would be more anxious to know it than his head office. And with a local committee in the country and a central committee in Winnipeg, or Calgary, or Regina, we might hope to get somewhere."

By way of summary, if the personnel can be and is carefully selected and if administrative policies are such as to decentralize authority and delegate it to local managers, local advisory boards and district superintendents, the managers and their banks can take as much interest and be as cognizant of local needs as unit banks. Above all, they can extend larger amounts of credit, at lower rates, and stand behind their customers in a way impossible for local banks.

Rural Credits. During the past few years there has been considerable discussion in Canada on the subject of long-term agricultural credits. The feeling is that the chartered banks adequately finance the seasonal or temporary needs of the farmers but that the same can not be said as to the availability of long-term or intermediate credit. As Professor Swanson testifies, the chartered banks have been most liberal, but they can not, and as commercial banks, should not give the type of credit so urgently needed in the West.[295] The type of credit urgently needed is that supplied by the Federal Land Banks and the Federal Intermediate Credit Banks in the United States. The Canadian farmer has

[295] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, p. 801. As stated by Sir Frederick Williams-Taylor, in recent years, some of the loans have through renewals run as long as five years, but this was quite exceptional. *Ibid.,* p. 340.

been securing his mortgage credit from loan or insurance companies or in some Provinces from provincial mortgage banks but either the amounts have been inadequate, or the interest rates high or the duration altogether too short. Everyone who has studied the subject realizes that Governmental mortgage banks are desperately needed. Through a federal farm loan bank the farmers might secure adequate investment credit, amortized over a long period of years and at low rates of interest. Secured by farm mortgages the bonds would offer a most attractive investment and the farmers would have access to the investment money markets. A plan for such an institution was recommended by Dr. H. M. Tory, President of the University of Alberta, who had been selected by the then Acting Minister of Finance to investigate land banks abroad and the need for these in Canada. His recommendations were to the effect that the Dominion Government should raise funds through bond issues which would then be loaned to those Provinces in which provincial machinery for the making of mortgage loans existed and through which the monies in turn could be loaned the farmers. A bill (No. 237) embodying his plan was introduced in the House of Commons in June, 1925, but failed of passage in the Senate. A much more elaborate measure (No. 148) creating a Canadian Farm Loan Board, with powers and responsibilities quite similar to those possessed by the Federal Farm Loan Board in the United States, was introduced a year later and passed the House of Commons on June 1, 1926, but failed of final enactment. The absence of any such system is a real defect in the Canadian banking structure, in the availability of credit.[296]

THE QUESTION OF A MONOPOLY. Bearing further on the availability of credit, is the question of a banking monopoly in Can-

[296] For a further discussion read Professor McGibbon's report, pp. 43–44; Professor Swanson's testimony before the *Special Committee on Agricultural Conditions,* 1923, pp. 1459–1460; also pp. XXII–XXIII; Report of the Special Committee on Agricultural, Industrial and Trade Development, The Senate of Canada, 17; Report on Agricultural Credit by H. M. Tory, Printed by Order of Parliament, 1924, also Supplementary Report, 1926; Professor W. T. Jackman, Report of Committee on Rural Credits, Ontario Department of Agriculture; and Agricultural Loans, a pamphlet issued by Department of the Interior, Ottawa. *Evidence of Witnesses on Bill 148,* Select Standing Committee on Banking and Commerce, The Senate of Canada, Session of 1926.

ada. The existence of this is frequently asserted and good folks are supposed to shudder without having much idea what is meant. A monopoly might manifest itself in extortionate interest rates, in discriminating between borrowers of equally good credit standing and in favoring one interest instead of the other. Those who make this charge, as is typical of like-minded persons in the United States, do not often indicate concisely or exactly why they feel this to be true. Of course, some say that the fact that a uniform rate of interest, 3%, is paid by all banks (except the Weyburn Security Bank) on time deposits is proof positive. But uniformity need not be an indication of a monopoly. If this were so, then the clearing house banks in New York City constitute a monopoly as many of their practices are made uniform through clearing-house agreement. Others allege that the uniformity of interest rates through a particular district is indicative of a monopoly. Yet this is not necessarily true for in a highly competitive market such as in wheat, there is only one price at a given time. And further, this argument fails when we remember that interest rates in Western Canada, where most of the monopoly proponents live, are lower than in similar parts of the United States. Or again people allege that the difficulties in the way of forming a new bank are almost insuperable if The Bankers' Association be opposed but on the other hand the bankers helped in the organization of the Weyburn Security Bank and did not oppose in any formal way the organization of the Bank of Vancouver though they felt it to be ill-fated.

Professor McGibbon reported [297] that in his opinion there is a monopoly, if we define monopoly as an organization with a substantial control over price, which was evidenced by the sudden change in the practice of the banks in the West from making straight loans to farmers to discounting their notes thereby increasing their interest charges. The possible existence of a monopoly was a question much discussed before the House Banking and Commerce Committee in 1923. Professor Swanson expressed the thought that competition did exist which took the form of competition in service rather than in charges.[298] Mr. H. O. Powell

[297] See p. 21.

[298] *Proceedings of the Select Standing Committee on Banking and Commerce,* 1923, pp. 797 and 807.

of the Weyburn Security Bank declared competition was keener in Canada than in the United States.[299]

In reply to a letter addressed by the writer to a group of Canadian economists whose opinions ought to be entirely objective, respecting the existence of a money trust, the following six replies were received. Only two of these state quite definitely that there is a monopoly. A third states that if there is, it is of the loosest sort. These are quoted in full for their value in throwing light on this much-mooted point:

Source A.: The criticism that the Canadian banks constitute a banking monopoly is well founded. They all pay the same rate of interest on deposits and charge the same rate on loans. The loaning provisions are virtually identical. Moreover, if a new bank were seeking incorporation, The Canadian Bankers' Association reports upon the fitness of the incorporators to undertake the work of a bank and if their report to the Minister of Finance is not favorable the charter will be refused. Is not this monopoly?

Source B.: We hear a lot in certain quarters about a "money trust." I do not deny the possibility of such a development but with the keenest competition between the chartered banks, it seems to me there is no practical danger of it.

Source C: I think that this criticism (that the Canadian Banks do constitute a monopoly) is well founded. Through The Canadian Bankers' Association the Canadian Banks are, in many respects, one bank. In a great many respects uniformity is insisted upon and a bank that protests had better look out. It is almost inconceivable that any capitalists would seek a charter for a new bank and yet on the face of it there is nothing to prevent them.

Source D: There is no monopoly. Any group of reasonable men — and no others should be considered, can obtain a charter on providing $250,000 in cash, and meeting the provisions of the Bank Act. I have only to refer to the unhappy experience of the defunct Farmers Bank to make it clear that the stringent scrutiny of any application of a group of men for a charter is justified. On the other hand, among the banks themselves there is the keen-

[299] *Ibid.*, p. 414.

est kind of competition, except in the item of interest paid on time deposits — which is determined by agreement at 3%. But when the Trust Companies provide checking accounts on which 4% is paid, so that there is no great hardship here; although some may say that such an agreement among the banks themselves to pay no more than 3% on time deposits may savour of monopoly.

Source E: I do not believe that there is a banking monopoly in Canada. Of course there is considerable concentration of banking power. We have only 17 banks at the present time; [300] five of these have 75% and seven 85% of the total banking assets of the country. It is true also that under our Bank Act The Canadian Bankers' Association exercises important powers, that there is very close touch between the leading Canadian bankers, and that there is a common bankers' opinion in this country. It is true also that the rate paid on deposits is the same and that all through there are very slight differences in charges for services made by the banks. The competition shows itself in a competition of service, however. As already hinted, the spreading branches might be regarded as an instance of excessive competition.

We have a free banking system and any new bank may be started in this country at any time, provided that the minimum capital can be raised, and that the backers of the project can satisfy the Committee of the House in regard to their honesty, competency and financial backing. It is true, however, that the most recent project for a Canadian bank, the Great West Bank, has fallen through. I think, myself, that the personality of the promoters had a good deal to do with this. One might also admit that a new bank would find it somewhat difficult to develop new business, especially in the first few years of its existence because the service rendered by the other banks is, on the whole, efficient.

Source F: There is some foundation, I think, for the criticism that the Canadian banks constitute a banking monopoly, but it is a monopoly of the loosest sort, involving at most, I think, certain bank agreements as to practices. Between the local branch managers there is a very keen competition. There is also very keen competition with regard to the locating of branches.

[300] In 1922.

If there be a monopoly in banking in Canada it does not seem to rebound to the pecuniary advantage of the banks. Interest charges, all things considered, are reasonable and dividends paid are lower than those of the National Banks in the United States. Its effect, if such exists, on the price of credit (excepting Professor McGibbon's example) is negligible. As regards the uniformity of rules respecting interest paid on deposits, etc., these are to be found over the entire world and, if indicative of monopoly, then such exists in banking everywhere, in New York City as in Canada. This agreement or arrangement is for the protection of the banks and the 3% rate is probably all that they can afford to pay at the present time. It is true that the attitude of the bankers toward legislation has been more or less shaped by the larger banks in The Bankers' Association but if this be a sign of a monopoly, it is true in bankers' associations everywhere and is not peculiar to Canada alone. There is undoubted competition in getting business, establishing branches and in securing deposits through better service and convenience of location.[301]

SAFETY

In the previous sections we have looked upon the Canadian banking system from the point of view of the borrower, from the point of view of the availability of credit to the business man or farmer. On the whole we found that the branch type of banking system in Canada meets the needs of most economic classes in the community satisfactorily, better in fact than a unit independent type of banking system could. Now we plan to shift our emphasis and view the Canadian system from the point of view of the safety of the depositors which is another of our tests of the excellence of any banking structure.

From a statistical point of view, bank failures as the measure of the safety of a banking system present many difficulties. In addition to the lack of adequate data, particularly as regards the results of receivership, the first and immediate prob-

[301] For further statements on this problem see 1913 hearings, p. 204; Debates of House of Commons, 1913, pp. 1877, 1928, 10672–10673, 2422; J. F. Johnson, *The Canadian Banking System,* p. 86; 1923 hearings, p. 948 and 915; and Debates of House of Commons, 1923, p. 4047.

lem encountered is the definition to be given a failure. Of course there are cases which admit of no doubt such as the Home Bank episode which represented the case of an institution closing with heavy losses to the depositors. But in addition to such a clear-cut case there are many of a border-line variety. For example, would one consider a bank to have failed if the shareholders lost all their investment even if the institution were reorganized overnight or merged with another bank with no loss to the depositors? Certainly from the point of view of the stockholders, the bank has "failed" though the depositors' funds be intact. Finally if we wish to make international comparisons, the many variations and imperfections in the raw data make these most difficult if not altogether useless.

The table shown on pages 480 and 481, kindly prepared by Mr. H. T. Ross, Secretary of The Canadian Bankers' Association, purports to give the statistics of bank failures in Canada since confederation. There are listed in all 26 liquidations. With the exception of two the note holders were paid in full and in the case of 13 of the banks, or one half, the depositors were paid in full and, in the case of two, received more than 96 cents on the dollar. The payments to depositors in the other cases ranged from nothing to 75¼%.[302]

Failures in Canada have for the most part resulted from mismanagement and dishonesty on the part of officials at the head offices and have not been due to mismanagement or dishonesty on the part of branch managers. The internal inspection or audit system of the banks, as Sir Thomas White, at one time Minister of Finance, pointed out in 1913, has worked fairly well. The fraud and dishonesty which have wrecked the banks have generally taken place at the head office which has been concealed from the inspectors and honest officers of the banks.[303] This point of view was also substantiated by Mr. George Edwards, in the 1924 hearings,[304] that in the main bank failures in Canada were due to causes which could be ascertainable by an examination of the head office accounts. Head office loans

[302] Mr. Ross' table, with some variations, is similar to one appearing in the 1913 hearings, p. 633.
[303] *House of Commons Debates,* Vol. CVII, p. 1847.
[304] See p. 24.

RETURN SHOWING THE NUMBER OF CHARTERED BANKS THAT HAVE GONE INTO LIQUIDATION SINCE 1867

Name of Bank & Chief Office	Date of Charter	Date of Suspension	Number of Branches at date of Suspension	Capital Stock at Date of Suspension			Reserve Fund
				Authorized $	Subscribed $	Paid up $	$
1. Commercial Bank of N. B., St. John, N. B.	Incorp'd 1834 in N. B.	1868		....	600,000	600,000	......
2. Bank of Acadia, Liverpool, N. S.	June 14, 1872	April, 1873		....	500,000	100,000	......
3. Metropolitan Bank of Montreal	Apr. 14, 1871	Oct. 1876		1,000,000	1,000,000	800,170	......
4. Mechanics' Bank of Montreal	Before Confederation	May, 1879		1,000,000	243,374	194,794	......
5. Bank of Liverpool, Liverpool, N. S.	Apr. 14, 1871	Oct. 1879		500,000	500,000	370,548	......
6. Consolidated Bank of Canada, City Bk. & Royal Can'n. amal. 1879	Sept. 18, 1875	Aug. 1879		2,400,000	2,091,900	2,080,920	......
7. Stadacona Bank, Quebec	June 14, 1872	July, 1879[1]		1,000,000	1,000,000	991,890	......
8. Bk. of Prince Edward Island, Charlottetown, P. E. I.	Local	Nov.28, 1881		....	....	120,000	45,000
9. Exchange Bank of Canada, Montreal	Apr. 14, 1871	Sept. 1883		500,000	500,000	500,000	300,000
10. Maritime Bk. of Dom. of Can., St. John, N. B.	June 14, 1872	Mar. 1887		2,000,000	321,900	321,900	60,000
11. Pictou Bank, Pictou, N. S.	May 23, 1873	Sept. 1887[1]		500,000	500,000	200,000	Nil.
12. Bank of London in Canada, London, Ont.	May 25, 1883	Aug. 1887[1]		1,000,000	1,000,000	241,101	50,000
13. Central Bank of Canada, Toronto, Ont.	May 25, 1883	Nov. 1887		1,000,000	500,000	500,000	45,000
14. Federal Bank, Toronto, Ont. (Changed from "Superior Bk.")	May 26, 1874	Jan. 1888[1]		1,250,000	1,250,000	1,250,000	150,000
15. Commercial Bank of Manitoba, Winnipeg, Man.	Apr. 19, 1884	June 30, 1893		2,000,000	740,700	552,650	50,000
16. Banque du Peuple, Montreal	June 27, 1844	July 15, 1895		1,200,000	1,200,000	1,200,000	600,000
17. Banque Ville Marie, Montreal	Nov. 1872	July 25, 1899		500,000	500,000	479,620	10,000
18. Bank of Yarmouth, Yarmouth, N. S.	Apr. 15, 1859	Mar. 6, 1905		300,000	300,000	300,000	35,000
19. Ontario Bank, Toronto	May 27, 1857	Oct. 13, 1906	29	1,500,000	1,500,000	1,500,000	700,000
20. Sovereign Bank of Canada, Toronto	May 23, 1901	Jan. 18, 1908	88	3,000,000	3,000,000	3,000,000	Nil.
21. Banque de St. Jean, St. Johns, Que.	May 23, 1873	Apr. 28, 1908	1	1,000,000	500,000	316,386	10,000
22. Banque de St. Hyacinthe, St. Hyacinthe, Que.	May 23, 1873	June 24, 1908	1	1,000,000	504,600	331,235	75,000
23. St. Stephens Bank, St. Stephens, N. B.	About 1836	Mar.10, 1910	1	200,000	200,000	200,000	55,000
24. Farmers' Bank, Toronto	Nov. 1, 1906[3]	Dec. 19, 1910	31	1,000,000	584,500	567,579	Nil.
25. Bk. of Vancouver, Vancouver	Mar. 1910	Dec. 1914	11	2,000,000	587,400	445,188	Nil.
26. Home Bank of Canada, Toronto	Jan. 2, 1906	Aug. 17, 1923	63[4]	5,000,000	2,000,000	1,960,591	550,000

RETURN SHOWING THE NUMBER OF CHARTERED BANKS THAT HAVE GONE INTO LIQUIDATION SINCE 1867

Name of Bank & Chief Office	Rate of Dividend %	Circulation $	Deposits $	Liabilities at date of Suspension $	Assets as per returns at date of Suspension $	Amount Paid to: Note holders %	Amount Paid to: Depositors %
1. Commercial Bank of N. B., St. John, N. B.	..	....	304,368	671,420	1,222,454	100	100
2. Bank of Acadia, Liverpool, N. S.	..	....	17,959	106,914	213,346	[2]	......
3. Metropolitan Bank of Montreal	..	40,447	129,731	293,379	779,225	100	100
4. Mechanics' Bank of Montreal	..	168,132	253,546	547,238	721,155	57½	57½
5. Bank of Liverpool, Liverpool, N. S.	..	3,668	86,263	136,480	207,877	100	96 6/17
6. Consolidated Bank of Canada, City Bk. & Royal Can'n. amal. 1879	..	423,819	1,013,934	1,794,249	3,077,202	100	100
7. Stadacona Bank, Quebec	..	152,481	188,372	341,500	1,355,675	100	100
8. Bk of Prince Edward Island, Charlottetown, P. E. I.	..	264,000	463,000	1,108,000	953,244	59½	59½
9. Exchange Bank of Canada, Montreal	8	467,385	2,206,377	2,868,884	3,779,493	100	66⅜
10. Maritime Bk. of Dom. of Can., St. John, N. B.	6	314,288	1,091,570	1,409,482	1,825,993	100	10¾
11. Pictou Bank, Pictou, N. S.	Nil.	49,571	17,474	74,364	277,017	100	100
12. Bank of London in Canada, London, Ont.	7	209,045	680,954	1,031,280	1,310,675	100	100
13. Central Bank of Canada, Toronto, Ont.	6	492,855	2,125,040	2,631,378	3,231,518	100	99¾
14. Federal Bank, Toronto, Ont. (Changed from "Superior Bk.")	Nil. 6	670,492	1,005,446	3,449,499	4,869,113	100	100
15. Commercial Bank of Manitoba, Winnipeg, Man.	6	396,890	771,456	1,341,251	1,951,151	100	100
16. Banque du Peuple, Montreal	7	818,648	6,874,217	7,761,209	9,533,537	100	75¼
17. Banque Ville Marie, Montreal	6	261,870	1,504,665	1,766,841	2,267,516	100	17½
18. Bank of Yarmouth, Yarmouth, N. S.	5	50,409	276,505	388,660	723,660	100	100
19. Ontario Bank, Toronto	7	1,351,402	12,656,034	15,272,271	15,920,307	100	100
20. Sovereign Bank of Canada, Toronto	6	1,988,585	11,215,506	16,174,408	19,218,746	100	100
21. Banque de St. Jean, St. Johns, Que.	4	219,334	340,004	560,781	326,118	100	30.271
22. Banque de St. Hyacinthe, St. Hyacinthe, Que.	6	253,860	918,770	1,172,630	1,576,443	100	100
23. St. Stephens Bank, St. Stephens, N. B.	6	149,935	386,160	549,830	818,271	100	100
24. Farmers' Bank, Toronto	4	429,470	1,314,016	1,997,041	2,616,683	100	Nil.
25. Bk. of Vancouver, Vancouver	Nil.	254,762	555,352	912,137	1,532,786	100	Nil.
26. Home Bank of Canada, Toronto	7	1,724,165	15,236,000	18,486,978	Nominally in excess of liabilities	100	25% interim, Dec. 22, 1923 and 35% to depositors of less than $500, Sept., 1925.

[1] Voluntary.

[2] This bank was only in existence three months and twenty-six days. It re-opened for a few days and redeemed a few thousands of its notes. This only lasted a day or two, and the remaining noteholders with the exception of the Government got nothing. The Dominion Government received 25 cents on the dollar on several thousand dollars worth of notes which it held. [3] Date of Treasury Board Certificate. [4] Plus 15 sub-agencies.

N. B. No Bank that has failed since 1895 has paid anything to shareholders. There is no reliable information as to earlier dates.

were cited by Mr. J. C. Saunders also as the chief reason for bank failures.[305] If this point of view be correct, that the head offices are responsible for the majority of bank failures, then the present system of shareholders' audits and of Government inspection should cut down if not eliminate bank failures in Canada. In addition to this present greater degree of supervision, it must also be remembered that the provisions regarding the organization and incorporation of banks have been strengthened and that many of the banks which failed in the past could not be incorporated under the present act.

Double Liability. Canadian bank stock, as does the stock of National Banks and of banks organized in most states, bears double liability. While the banks would probably like to see this feature eliminated,[306] for they feel it is a deterrent to the sale of their stock, it has been of real protection to the depositors as the following table indicates: [307]

Name of Bank	Amount of Subscribed Capital	Amount Collected from Double Liability
Banque de St. Jean	$ 500,000	$ 161,000
Banque de St. Hyacinthe	504,000	156,000
Farmers Bank	584,000	314,000 (To March 12, 1924)
Bank of Vancouver	587,000	149,000 (To April 13, 1923)
The Ontario Bank	1,500,000	1,202,510
Bank of Yarmouth	300,000	264,667

Unfortunately these seem to be the only figures made public respecting the effectiveness of the double liability. In passing it might be suggested as a possible reform that the curators and liquidators of Canadian banks should make periodic, full and detailed reports respecting the results of the receivership which should be made public.

It is frequently alleged at bankers' conventions in the United

305 *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, p. 363.

306 See testimony of Mr. C. E. Neill, *Proceedings of the Select Standing Committee on Banking and Commerce,* 1924, pp. 257–258.

307 *Ibid.,* p. 307. See also 1913 hearings, p. 222.

States that bank failures in Canada have been more frequent and have involved larger liabilities than those in the United States. Since such statements are frequently and loosely thrown about, an attempt is made in the following table to compare bank failures in Canada and the United States on the basis of the per capita liabilities of failed banks in each country. The table clearly shows that the liabilities involved have been proportion-

BANK FAILURES IN THE UNITED STATES					FAILURES OF CHARTERED BANKS IN CANADA			
Year	Number	Total Liabilities	Population of U.S.A.	Liabilities per Capita (in Dollars)	Number	Liabilities	Population of Canada	Liabilities per Capita (in Dollars)
1900	59	35,617,563	75,994,575 *	.4687	0	....	5,322,000	.....
1	74	18,018,774	77,747,402	.2318	0	....	5,371,315 *	.....
2	63	10,969,072	79,365,396	.1382	0	....	5,532,000	.....
3	121	29,685,766	80,983,390	.3666	0	....	5,673,000	.....
4	99	28,158,811	82,601,384	.3409	0	....	5,825,000	.....
5	78	20,227,155	84,219,378	.2402	1	388,660	5,992,000	.0648
6	58	18,805,380	85,837,372	.2191	1	15,272,271	6,171,000	2.4748
7	132	233,325,972	87,445,366	2.6682	0	....	6,302,000	.....
8	180	123,126,956	89,073,360	1.3823	2	16,735,189	6,491,000	2.5782
9	80	24,677,128	90,691,354	.2713	0	....	6,695,000	.....
1910	119	41,097,255	91,972,266 *	.4468	2	2,546,871	6,917,000	.3682
1	107	25,511,606	93,682,189	.2723	0	....	7,206,643 *	.....
2	79	24,219,522	95,097,298	.2547	0	....	7,365,205	.....
3	120	31,546,314	96,512,407	.3269	0	....	7,527,208	.....
4	212	56,005,107	97,927,516	.5719	1	912,137	7,692,832	.1185
5	133	37,223,234	99,342,625	.3747	0	....	7,862,078	.....
6	50	10,396,779	100,757,735	.1032	0	....	8,035,584	.....
7	42	18,451,964	102,172,845	.1806	0	....	8,180,160	.....
8	20	5,131,887	103,587,955	.0495	0	....	8,328,382	.....
9	50	16,520,862	105,003,065	.1573	0	....	8,478,546	.....
1920	119	50,708,300	106,421,621 *	.4770	0	....	8,631,495	.....
1	404	173,027,776	108,444,777	1.6000	0	....	8,788,483 *	.....
2	277	77,735,551	109,893,003	.7070	0	....	8,940,150	.....
3	578	203,739,138	111,693,474	1.8200	1	18,486,978	9,082,840	2.0353
4	613	202,926,206	113,727,432	1.7900	0	....	9,226,740	.....
5	464	164,698,510	115,378,094	1.4300	0	....	....	.....
6	608	212,074,999	117,135,817	1.8100	0	....	....	.....
Arithmetic mean of per capita liabilities — 27 years:				.6925	Arithmetic mean of per capita liabilities — 27 years:			.2829

Source: Failures in the United States, *Dun's Review*.
Failures in Canada, Secretary, The Canadian Bankers' Association.
Population of the United States, *Statistical Abstract of the United States* (1925, p. 3)
Population of Canada, *The Canada Year Book*, 1924, p. 743.

* Census years; population in other years estimated.

ately less in Canada where deposits are safer than in the United States. In the period covered the arithmetic mean of the per capita liabilities of failed banks in Canada has been .2829, while in the United States it has amounted to .6925 or more than three times as much.

From the point of view of safety the Canadian system seems superior to that existing in the States and this superiority should become more marked as time goes on with the closer scrutiny of banks. Of course, in comparison with the British or Australian banking system, especially since 1900, the Canadian system suffers. It has not been as safe as those. But with the " house cleaning " which has occurred since the war, it is to be expected that the Canadian record in future years will be materially better. But even as it is the past record has been superior to that of the United States where drastic measures are needed to reduce the number of failures.

CREDIT CONTROL

Still another and final test we shall seek to apply of the adequacy of a banking system is the extent to which it stabilizes business, prevents panics, and mitigates the amplitude of cyclic fluctuations. Perhaps, all in all, this is one of the most important services a banking system, usually under the guidance of a central bank, can render. Prior to the Federal Reserve System, the American banking system was particularly deficient in this respect. The thousands of banks were unable to cope with inflation and speculation and as a matter of fact their influence was exerted largely in the direction of intensifying business fluctuations and consequently of increasing business failures and disasters. United or concerted action among the thousands of unit banks in the matter of credit control was impossible. Each followed its own policies which were calculated for the most part to push out loans and resources to the maximum making it impossible to cope with the critical period accompanying and following a crisis. Panics invariably ensued as the banking system broke under the strain. The inherent weaknesses in the American banking system were brought out in bold relief in the panic of 1907. There

were ominous signs portentous of a coming storm as early as 1906, which were quite unheeded in the United States although made the basis for the credit policies of the Bank of England which was fully prepared when the time came.

The United States now has 12 regional banks which are expected to follow business developments closely and to modify their discount and open market operations accordingly. Not that they always have been able to do this, for in 1915 and 1916 they were too weak to affect the economic situation, and in 1917, 1918, and 1919 they were forced to subordinate their policies to the mistaken ideas of the Treasury Department and even on occasion since then their policies have been such as to intensify the cycle. However mistaken their policies might have been, it is generally recognized by students that one of their real functions, as that of any central bank, is to stabilize prices, in so far as is possible, and the general economic situation.

In Canada there is no central bank which leads the other banks or whose policies of credit control may be studied in the variations in its rate of discount or holdings of purchased bills and securities. Each bank in itself is in a sense a central bank on whose policies of credit control little has been written and little known.

In fact there is probably little attempt to formulate a conscious policy of credit control on the part of the chartered banks.[308] Such is rarely done by commercial banks. The chartered banks, it is true, do have certain more or less mechanical rules to guide them in preventing undue extensions of credit, as would be the case with well managed banks everywhere. Thus they feel that their cash holdings should equal about 10% of their liabilities, certainly no less. In case these fall below, they would probably curtail their loans. Then again some of the banks follow the statements of the others to see if theirs are out of line or if perchance any of the others have expanded or contracted unduly. And to a certain extent the chartered banks are guided by the credit policies of the Bank of England [309] and the Federal Reserve Banks as one might expect from the closeness of the economic relations between the countries.

[308] For a discussion of credit control in Canada see article by A. W. Flux, in the *Yale Review*, Vol. XVII, p. 93; and also one in the *Journal of the Canadian Bankers' Association*, Vol. 29.

[309] *Minutes of Proceedings, Evidence, etc.*, 1913., p. 239.

The policies followed by the chartered banks in certain crises have been fairly well developed. Thus Sir Edmund Walker, in testifying in 1913,[310] indicated that the chartered banks in 1907 drew in their call loans from the United States and England, disposed of securities, and pressed those of their larger borrowers, who were able to do so, to fund their bank loans into bonds. Their policy has been to support their customers, in so far as they require such support, and to withdraw funds from abroad. Of course now the banks may borrow from the Government, a method not available in 1907. Mr. H. C. McLeod testified that the Bank of Nova Scotia " kept the lid on " in 1907, but endeavored not to press it too hard, recognizing that the business man must be supported if his patronage is to be retained.[311] The crisis financing of the chartered banks was such that no acute disturbances were felt in 1893 and 1907, notwithstanding the suspension of specie payments in the United States. In fact the chartered banks were able in both instances to advance funds to move the harvests of Minnesota and the Dakotas when American funds were not available.

At times the banks, or the larger ones and the Government seem to agree on a common credit policy. It is probable that such was the case during the war when every effort was being made to increase production, and when the farmers were urged to produce more and more. They responded vigorously to this appeal and invested (unfortunately) heavy amounts in lands, machinery, and live stock. The banks did all they could to assist the farmers feed the armies of the Allies. In 1920 when deflation occurred not only in Canada but throughout the world, in Japan, Australia, South Africa, England, and the United States, in fact in all countries not wallowing in increased issues of paper money, the bankers in Canada, too, curtailed credits and probably, informally, at meetings of The Bankers' Association, discussed what should be done. Not that the bankers are to blame for the deflation. It was world-wide, the aftermath of the financing of the war. Credit had to be curtailed if prices were to fall. The rapid fall in prices bore with terrible severity on all classes and

[310] *Minutes of Proceedings, Evidence, etc.*, 1913, p. 551. See also p. 567.

[311] *Interviews on the Banking and Currency Systems of Canada*, pp. 47–48.

especially on the farmers, whose prices fell furthest, as was true in the United States, England and elsewhere. But as explained before, the Canadian farmer did not suffer to the same extent as did the American farmer, for the banks supported and carried him along.[312]

While we know little regarding the policies of the Canadian banks and the methods they employ in exercising credit control, in the sense of lending stability to business, we do know that they support the business man in periods of recession, which according to Walter Bagehot[313] is the correct method of crisis financing. We do know that to do this the banks call home their foreign loans and deposits and put pressure, if need be, on the large business man. We do know that the chartered banks have a more or less mechanistic concept of the proportion of cash they ought to maintain to liabilities and that this acts as a check on over-expansion as effectively as would legal minimum cash reserves. Then we know that each bank follows the balance-sheets of the others and so develops what might be termed a " balance-sheet " concept of credit control. Then at times it seems apparent that the Government and the banks have reached a common understanding on loans and investments as during the war period. However, all things considered, we know little compared with our knowledge of the policies followed by the Federal Reserve Banks. But we do know that Canada, whether because or in spite of the stabilizing influence of her banking system, has had more years of prosperity per years of depression than any other nation.[314]

[312] For a further discussion of deflation in Canada see Professor McGibbon's report, pp. 26–28; Professor Swanson's testimony, 1923 hearings, p. 776. Of course the bankers in Canada, as elsewhere, declared that credit contractions followed a fall in prices. See testimony of Sir John Aird, 1923 hearings, p. 355. Sir Edmund Walker expressed the same thought. On the other hand, Sir Frederick Williams-Taylor held an opposite point of view. (1923 hearings, p. 325.)

[313] *Report from the Select Committee on Banks of Issue* (England) 1875, questions Nos. 8170, 8171 and 8172.

[314] Relative to the points developed in this section, the author received a letter from Prof. J. Courtland Elliott of the University of Saskatchewan which depicts the rôle of the banking system in Canada's economic development in a very realistic fashion.

In considering the relation of the chartered banks to the economic development of the Dominion, I feel it is essential that their influence be judged in terms of the tasks imposed upon them in a country undergoing rapid expansion. Within the limits of the existing legislation and in conformity

with established banking practices, they have had to face the problems of assuring safety to their note holders and depositors on the one hand, to supply adequate funds to legitimate borrowers on the other, and attractive earnings to the shareholders on " any other hand that may be left."

If you will picture the westward surge of population in the early years of this century into the wheatlands of this west, into the mining areas of Northern Ontario and the Klondyke, you will realize the financial requirements imposed upon the banks. The map of the north was rolled back and it was essential that the banks be in the vanguard. To me this is a thrilling and romantic part of Canadian banking and if you were to travel through the pioneer settlements out here you would realize, I am sure, how grateful we Canadians should be for the initiative of Canadian bankers. They may have been over-prudent in certain of their activities, but, subject to my possible bias of judgment, it seems to me that the advantages of our system have outweighed the disadvantages, and I feel that the structure of the banking system was well adapted to the pioneering processes of economic development. The device of branch banking could diversify the risks, render reserves more efficient, and enable unprofitable operation in new territory. The circulation privilege, it seems to me, was a stimulus which brought tangible developmental results. Moreover, there is one point that seems to me to be important which you may have overlooked. I have the impression that a unit banking system can function successfully only when there is a security market or an active money market nearby. Canada had neither, and it is only within the last ten years that anything approaching an adequate security market has developed in this country. The consequence is that even yet Canadian banks are dependent upon foreign money markets to adjust their internal banking position. How much worse it would have been with a system of unit banks where there would have been even a lesser mobility of funds, I will leave to your imagination.

CHAPTER VI

THE BANKING SYSTEM OF DENMARK

BY

PAUL GLINDEMANN

MONETARY SYSTEM

EARLY CURRENCY. In Denmark, just as in a great many other countries, the beginning of the eighteenth century witnessed an increasing use of money — a sign and cause of the transition from primitive to modern economy. The coins in circulation were silver coins in the unit of rigsdaler, and from 1713 paper money issued by the State circulated along with silver. This issue of paper money was not given the full legal tender power and it was not sufficiently backed by physical assets but derived its value from the fiat of the government, i.e., the King. Consequently its value declined heavily and in 1728 the notes were withdrawn from circulation. Eight years later, in 1736, the first Danish bank was established under the name of Kjobenhavns Assignations-, Vexel- og Laanebank, generally known as the Courantbank, a private joint stock company entitled to issue redeemable notes. The rising demand for loans, especially on the part of the State, tempted the new bank to issue notes in excess of its powers, and suspension of redemption was resorted to at intervals. In 1757 the suspension took on a more permanent nature and from then on the country was for 88 years without redeemable notes. The Courantbank was taken over by the King in 1773 and from that year its notes deteriorated into a kind of compulsory legal tender and, about 1790, they passed at a discount of from 20 to 30 per cent.

In 1807, just prior to the outbreak of war, the entire circulation amounted to 27 million rigsdaler. Attempts to reform the currency situation were thwarted by the prolonged war of 1807–14 during which conditions became nothing short of desperate. At

one time the circulation was as high as 142 million rigsdaler and the value of the notes had declined as low as 1/14. The government also was under necessity of having recourse to extensive issues of paper money which finally, exceeding the resources of the entire State, fell quite into discredit.

Then by Royal Ordinance of January 5, 1813, the State reduced the value of its notes to about 1/10 and established a new bank, the Rigsbank, to take over the note issue and withdraw the old notes from circulation. This bank constituted what was called a Royal Bank, a State institution, founded on the real estate of the Kingdom, the capital stock being procured by placing a first mortgage on all real estate for 6 per cent of the assessed value. These first mortgage rights on all real estate amounted to a total of 42 million rigsdaler, 27 millions of which were intended to be applied against redemption of the old note issue, whereas 15 millions were to be loaned to the State. Moreover, the bank was authorized to issue notes for 4 million rigsdaler in order to carry on an ordinary banking business. Obviously it was a very imprudent step to start the bank by authorizing it to grant a new loan of 15 million rigsdaler to the State. The whole arrangement was subject to much suspicion on the part of the taxpayers and considered by them as a new attack by the State. In order to create public confidence the government promised that in time the Rigsbank would be transformed into a private bank entirely separate from the national finances. In view of the prevailing sentiment this promise was of little avail and conditions did not improve until the Napoleonic Wars ceased.

New National Bank. Then in 1818, to reorganize the country's monetary system, the new National Bank was created to take over the business of the Rigsbank. In the Charter of July 4, 1818, the King fulfilled the pledge of the government by granting the note-issue privilege to the new bank, which was to be a privately owned joint-stock institution. As its foremost duty the National Bank was charged with the obligation of redeeming the old Rigsbank note issue. The bank undertook this very energetically, but the disorder of the monetary system was so complete that not until 1838 did the bank find itself in a position to bring the value of the notes up to par with silver.

In 1845 silver redemption was resumed, when the entire circu-

lation amounted to 16,500,000 rigsdaler and the bank was holding silver amounting to 8,650,000 rigsdaler. When redemption was resumed it was provided that there should always be a silver-backing of 50% and that the remaining 50% should be covered by first-class assets in the proportion of 150 rigsdaler value of assets to each 100 rigsdaler issued. As early as 1847 the maximum fixed in 1845 had to be raised to 20 million rigsdaler, and to provide sufficient capital during the boom-period of the early fifties the maximum was again increased in 1854 to 24 millions, the last increase of 4 millions to be covered in full by silver in coin or bars or bills of exchange in marks or sterling.

Crisis of 1857. The great commercial panic of November, 1857, had a significant effect on the Danish money market. The rapid commercial expansion during the years from 1854 to 1857, during which no less than 15 new banks were formed, brought about the usual results in the form of unsound business, speculative prices, and an extraordinary sensitiveness. The crisis had its origin in the United States, but it was the disastrous revulsions in Hamburg that caused the general alarm in Denmark. At that time the National Bank maintained intimate relations with several large Hamburg bankers, and when at the beginning of the crisis their suspension was imminent, the National Bank in Copenhagen had to intervene by granting comparatively large credits. To meet these credits as well as very heavy domestic requirements, the National Bank obtained large loans from the Treasury, and a special national loan company was formed to supervise the granting of financial help and support to commercial houses from the funds that had been received during the same year by the Treasury from foreign countries as compensation for the abolition of the Sound duties. During this period the rate of discount did not exceed 7% and it was kept at that height only for about three months, and this, taken in connection with the fact that rather large amounts were placed at the disposal of the market from other sources, made it possible to keep down the circulation to very reasonable amounts, fluctuating around 22 million rigsdaler. The entire banking system emerged from the crisis without sustaining heavy losses, the total loss of the National Bank amounting to 1,800,000 rigsdaler. The procedure of fixing an absolute maximum limit for the note issue was discontinued in 1859 and from

then on notes could be issued up to any amount provided the rules as to metallic cover were duly adhered to.

The War of 1863–1864. The war between Denmark and Germany did not come as a surprise. For that reason the National Bank had been able to strengthen its position to a great extent. Its silver holdings were increased to 13 millions and a portfolio of mark- and sterling-bills amounting to 4 millions was built up. The circulation rose as high as 27 million rigsdaler, but fortunately the war was of short duration — only about 10 months — and after the end of the year 1864 the National Bank was able to bring about a contraction of the note circulation. The next ten years were a period of marked prosperity and industrial activity which required an increasing use of circulating money, and the year 1874 saw a note circulation of more than 32 million rigsdaler, all of which except 13½ millions was covered by silver.

The Adoption of the Gold Standard. When Germany adopted the gold standard in 1872, it was deemed advisable to grant the National Bank permission to include gold bullion and coin in the metallic reserve and it was provided that the proportionate ratio of value should be calculated at 15½ to 1 and that silver stock should always be at least one half of the total reserve. Finally, in 1873, the full gold standard was adopted. The moment for the adoption was very prudently chosen. The balance of trade was favorable; other neighboring states were deliberating whether to make the change which made it easy to sell the main part of the silver holdings of the National Bank and to buy the necessary amount of gold. From January 1, 1875, the Currency Act came into operation. Besides the gold standard this act also provided for a change of the unit of Danish money — namely, from the rigsdaler or rigsbankdaler to the krone of 100 oere. The intrinsic value of an old rigsdaler was exactly 2 kroner. The new gold pieces were coined from gold 9/10 pure, and from one kilogramme of pure gold an amount of 2480 kroner was obtained. The act also provided new rules regarding metallic cover for the note circulation. Particularly it authorized an issue of 27 million kroner of notes without metallic cover and provided that any issue above that amount should be covered by gold, and that the metallic reserve should never fall below 3/8 of the actual circulation and that the 27 millions not covered by metal should be backed by good and substantial assets, readily available, in a

proportion of 100 kroner of notes issued against 150 kroner of assets.

Some years later the National Bank was allowed to calculate as a part of its metallic reserve its demand balances with the Norges Bank and the Sveriges Riksbank and later on this permission also included the German Reichsbank. At that time it was arranged that all amounts due from the National Bank to these banks should be deducted in the calculation of the metallic reserve.

The Currency Act with later supplementary acts also provided for the Scandinavian Monetary Union into which entered Denmark, Sweden and Norway. The effect of the agreement between these three countries was that gold coins as well as silver and bronze coins of any of the countries were legal tender in any of the others. Some years later this was extended to include also the paper money of these countries, and when the banks of issue inaugurated a system of drawing and protecting drafts on each other without exchange, thus obviating gold shipments to a great extent, the Scandinavian Monetary Union became an almost ideal arrangement. During the last years before the World War quite heavy gold shipments from Denmark to Sweden took place, however, for various reasons, and it seemed at one time that the Union would have to be abandoned. The World War did finally put an end to the Union because of the suspension of gold payments and the rates of exchange fluctuating very differently for the three countries.

Recent and Present Currency. Under the rules of the Scandinavian Monetary Union the Danish coins were the following:

Amount		Diameter		Contents of Pure Metal		Metal
20	kroner	23	millimeters	8.06454	grammes	gold 9/10 pure
10	"	18	"	4.03227	"	gold 9/10 pure
2	"	31	"	12.0	"	silver 8/10 pure
1	"	25	"	6.0	"	silver 8/10 pure
25	oere	17	"	1.452	"	silver 6/10 pure
10	"	15	"	0.58	"	silver 4/10 pure
5	"	27	"	weight 8	"	bronze (95% copper 4% tin 1% zinc)
2	"	21	"	" 4	"	bronze (95 % copper 4% tin 1% zinc)
1	"	16	"	" 2	"	bronze (95% copper 4% tin 1% zinc)

Notes were issued in the denominations of 500, 100, 50, 10, and 5 kroner. Gold of course was made unlimited legal tender, and notes generally were accepted to be so although the National Bank Charter does not clearly state this. 1 and 2 kroner silver coins could be refused in amounts of more than 20 kroner, smaller coins for more than 5 kroner and bronze for more than 1 krone, provided, however, that State and Municipal offices were bound to accept 1 and 2 kroner silver coins without limit in payment of taxes and duties. During the War the National Bank was authorized by law to issue notes for 1 and 2 kroner. Actually only 1 krone notes were issued, and they were made legal tender for payments up to 20 kroner. These notes were later on withdrawn from circulation. During these years the small token coins for 5, 2, and 1 oere were made from iron, but in accordance with the Act of February 15, 1924, minting now takes place as follows:

alloy of copper, nickel and aluminum, 2 kroner, 1 krone, 50 oere,
alloy of copper and nickel (with a hole) 25 oere, 10 oere,
alloy of copper, tin and zinc, 5 oere, 2 oere, 1 oere.

All minting is in the hands of the Royal Mint.

Crisis of 1907. The years preceding 1907 were humming with industrial activity and prosperity which, at the time of the war between Russia and Japan, was extended to the mercantile marine in which the shipping boom caused a tremendous increase. At the same time an enormous building boom set in with a consequent real estate speculation supported by a few Copenhagen banks. When the international commercial crisis started in 1907, a number of maturing foreign credits were not renewed and this caused a rather heavy drain on the gold resources of the National Bank whose metallic reserves decreased, and although the rules regarding the note-cover were temporarily modified, the bank rate had to be raised to 8%. Distrust of the banks back of the building boom resulted in a run and suspension of payments of several banks at the beginning of 1908, but actual panic was averted when, without hesitation, the State and the large Copenhagen banks stepped in and guaranteed all creditors of the closed

banks and formed a liquidation office to undertake the winding up of the affairs over a long period of years.

Abandonment of Specie Payments. Immediately upon the outbreak of the World War, by an Act of August 2, 1914, the National Bank was released from its duty to redeem notes on presentation and on August 6 it was furthermore enacted that exportation of precious metals in coins or bars should be prohibited. The suspension of gold redemption was intended to be effective only until October 1, 1914, but the act was extended on several occasions, so that practically it was in force until the end of 1926, except for a period from April 30, 1917, until the end of 1918, when Danish paper currency had appreciated so much above the pre-war par that demand for gold stopped entirely.

Continuously the National Bank was entitled to refuse to give up gold for export purposes, a policy which from July 30, 1919, became even stricter so that the National Bank was permitted to refuse gold redemption when it had the slightest suspicion that the gold would be utilized to the damage of the public good. In April, 1916, the National Bank was also released from its obligation to buy gold at the par rate of 2480 kroner less ¼% seignorage per kilogramme pure gold and at the same time the Royal Mint discontinued its practice of minting gold for the public (for which service it had hitherto made a charge of ¼% for 20 kroner coins and ⅓% for 10 kroner coins). This changed the Danish currency entirely to paper currency with the possibility of wide fluctuations of the rates of exchange on both sides of par.

From 1915 to 1920 the National Bank increased its holdings of gold from 107 millions to 227 millions of kroner and during the same period the note circulation rose from 204 millions to 541 millions. On account of a favorable trade balance, enormous profits from shipping and in spite of gold imports, repurchases of Danish bonds from abroad, foreign capital investments, the krone appreciated as against dollars and sterling as high as 20% above par, but at the end of the War this changed entirely.

During the War Denmark had changed from a debtor to a creditor nation, but the collapse of the post-war boom and inflation had such far-flung influences on the Danish community that the situation was again reversed. For the two years of 1919 and 1920 the unfavorable balance of trade amounted to about

3000 million kroner. These huge imports were mainly for home consumption in satisfaction of the demands left over by the war period, but partly also for reëxport to Russia and the Baltic States. When hopes for such reëxport did not materialize on account of political uncertainties and confusion, Danish importers experienced years of exceptional losses, accentuated by the rising foreign exchange rates which brought the gold value of the Danish krone down as low as 50% of par in November, 1920. During these years the National Bank seems to have held the opinion which was common among continental central banks that the bank rate was not an effective weapon to check business fluctuations. The bank rate was unchanged at 5% from the middle of 1915 until January, 1919, when it was increased by ½%, and this was followed by increases to 6% in October, 1919 and 7% in April, 1920, but only by reason of the growing tightness of the money market.

The discount policy of the National Bank was at that time influenced enormously by national and political interests. A reunion with a part of the Duchy of Slesvic was imminent. According to the Versailles Treaty a referendum was to be held in Slesvic in the early part of 1920, and in order to provide funds for the expected reunion and to liquidate old war-time accounts the government floated 265 million kroner of loans in 1919 on the domestic market. In order not to influence these events unfavorably the increases of the bank rate which were more than justified by the entire situation were postponed as long as possible. The next few years saw a very fluctuating rate of the krone, partly by reason of unfavorable trade balance and partly on account of a general foreign distrust which was the result of the many bank suspensions and reconstructions and commercial bankruptcies which were the aftermath of the inflation period. In the year 1923 the National Bank exported some 20 million kroner of gold and at the end of the year the bank, together with the State and the large Copenhagen banks, formed the Stabilization Fund on the basis of foreign credits (for 125 million kroner) obtained in London and New York. So heavy was the demand for foreign exchange, however, that by January, 1924, half of this credit was used and the bank discontinued effort to keep the krone at a firm level. Not until the end of 1924 did the tide turn.

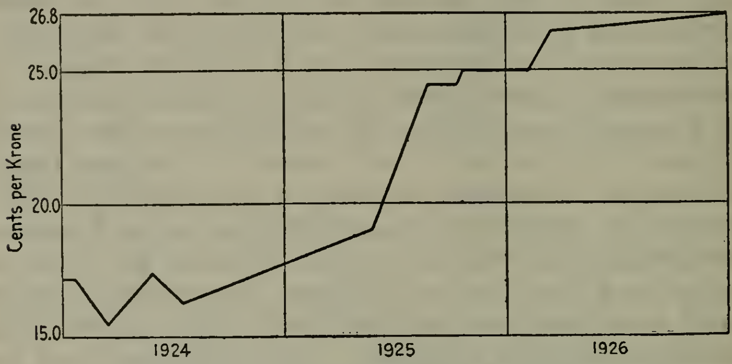
Return to Gold Standard. In spite of everything the economic conditions of the country changed for the better and the krone appreciated, but the subsequent events showed the hopeless and impossible mixture of State and Bank authority and responsibility — the unsolved question as to whether it is the Bank of Issue or the Legislature which is in a critical time to dominate a country's monetary credit system. The note circulation fell more than 100 million kroner below the top notch, and a number of legislative measures were added to the avalanche which had previously been passed for the betterment of the krone.

On March 29, 1924, the Central Exchange Office was established, among the various powers of which was the right to control foreign exchange transactions and to restrict dealings in foreign exchange to a small number of banks. The improvement of the krone exchange following the establishment of the Central Exchange Office was only of brief duration and soon new depreciation set in. The result of a conference called shortly after that event by the government was a stabilization act with broader principles for the return to normal conditions with a view to restoration of the par value of the krone. Increased taxation was levied, an exchange credit for $40,000,000 obtained in New York, the political factions temporarily ceased controversy and intrusted the obligation of keeping the krone rate within certain fixed limits to the National Bank. Denmark thus announced to the world her intention to see a sound krone.

Speculation in Krone. This as well as an unusually favorable trade position was seized by the exchange traders of the world as the basis for a tremendous speculation for the rise of the krone. The skyrocket appreciation of the krone took place largely through the persistent pressure of influences outside the Danish governmental policy, accentuated and accelerated as it was by heavy buying by professional groups. This was explained by the fact that during the period involved the Danish and the Norwegian exchanges offered almost the only opportunity for foreign exchange speculation, as most of the other important currencies either were too firmly stabilized to permit of fluctuations or were so uncertain that the risk in them was considered too great. It is estimated that this brought deposits of about 100 million kroner into the country and concurrent with

this increased interest of foreigners were the sales by Danish holders of their portfolios of foreign bills. At one time the holdings of the National Bank of foreign bills ran as high as 154 million kroner and its loans and advances decreased from 262 millions to 99 millions at the end of August, 1925.

The rising exchange, of course, brought with it many protests on the part of business and agricultural interests. The situation was aggravated by price adjustments and the country witnessed a deflation resembling the first sharp break in prices following the world-wide post-war inflation.



DANISH EXCHANGE AS QUOTED IN NEW YORK

THE NEW GOLD STANDARD. At the end of 1926 the price level was such, however, that a return to the gold standard was believed to be of little danger. At the time of the writing of this chapter (January, 1927), after an interval of more than 12 years, Denmark is then once more anchoring its currency to gold. It is no secret that when negotiations started regarding the resumption of gold redemption, general opinion favored a return to the pre-war unrestricted gold standard. The result of the negotiations, however, was the adoption of a restrictive policy along the lines followed by Great Britain when that country returned to gold in 1925: namely, the holding of gold as a reserve in the central bank while not allowing gold coin to get into circulation. Thus the new redemption act states that from January 1, 1927, the obligation of the National Bank to redeem its notes in gold again becomes operative, but that until the end of 1929 the Minister of Industry, Trade and Shipping shall be authorized to decide that

the bank shall be bound to effect such redemption only when notes are presented in multiples of 28,000 kroner, and then at the discretion of the bank only in Danish gold coin at face value or in gold bars or gold in other shape at the rate of value of 2480 kroner per kilogramme pure gold. The amount of 28,000 kroner represents the value of a gold bar of the international standard size whose weight is between 12 and 13 kilogrammes.

The necessary order has been issued by the Minister for a period of one year and is expected in time to be extended also for 1928 and 1929 at the end of which the question must be taken up by the Legislature for new consideration. At the time of resumption of gold redemption the National Bank holds a gold reserve of 209 million kroner. On November 30, 1926, its outstanding notes amounted to 378 million kroner as compared with 434 millions in 1925 and 479 millions in 1924. Below is a comparison with the position on July 31, 1914:

	December 23, 1926	December 23, 1925	July 31, 1914
Gold	Kr. 208,957,193	209,246,927	—
Silver and other coin...	14,820,500	13,295,716	—
	Kr. 223,777,693	222,542,643	73,340,674
Notes in circulation ...	366,950,112	420,930,336	156,472,655
Ratio	61.0%	52.9%	50.7%

New regulations have been issued regarding the export of gold from Denmark abolishing the restrictions hitherto enforced upon the export of silver and nickel coins. The export of gold coin and gold bars will accordingly be permitted only to those countries which permit gold exports themselves. Regarding the rules for the metallic cover, the regulations contained in the extended Charter again apply, viz., metallic cover must amount to not less than 50% of the amount of notes outstanding. Under the classification of metallic cover are included:

a. legal tender coin at face value,
b. gold bars and foreign gold coin at the rate of 2480 kroner per kilogramme pure gold,
c. demand balances with the central banks of Norway, Sweden, and Germany.

(a) must be at least 12½% of the total circulation and (a) plus (b) not less than 30%.

The fiduciary issue is to be covered by easily saleable assets in the proportion of 125 to 100. On excess-issues the Charter Act imposes a tax of 5% per annum payable to the Treasury. A return given in accordance with these rules is subjoined.

Return as of January 22, 1927

Metallic reserve:	
Gold, coin or bars	Kr. 201,640,938
Other coin	15,203,434
	Kr. 216,844,372
Demand balances with Sveriges Riksbank, Norges Bank and Reichsbank, Berlin	2,826,301
	Kr. 219,670,673
Notes in actual circulation	Kr. 326,222,032
Ratio	67.3%

The goal has been reached, but joy must still be moderate, as grave results of deflation are still at hand. The gold standard brings no immediate relief in that respect. It supports an existing state of affairs and adds vitality to stability. But working conditions for trade, industry, and agriculture will be unchanged, except for the fact that the most acute and obvious difficulty which has hampered the restoration of sound economic conditions has been done away with: namely, the fluctuating irredeemable paper money with which the country was doing its business.

The qualification for the last step must be that the full consequences of the arrangement be assumed — a sound adjustment of the economic state of affairs of the country. The demands of a krone at par have not yet been entirely met in the Danish administration and these demands will be stronger and more emphasized when the krone is finally anchored to gold. The Budget for 1925–1926 involved expenditures to a total amount of 382 million kroner, whereas the Budget proposal for 1927–1928, as submitted by the late Cabinet, figures with a total expenditure of 358 million kroner or a decrease of less than 8%. In the same period the price index of wholesale prices has fallen from 234 to 145, which brings out clearly that no country can go its independent way in the matter of commodity prices in a world in which trade takes place on an internationally substantial scale. The expendi-

ture of the State is thus still comparatively very high, and there should be a wide scope for government initiative in bringing down the expenditures to a more appropriate level. The gold standard does not carry in its wake a fear of loss of gold. Gold always flows willingly to countries which are willing to pay it out again. Confidence on that point is the whole question.

CREDIT INSTRUMENTS

The open book account, of course, in a sense is a credit instrument, being a measure of credit of the most elementary type. This form of credit extension is used in Denmark, it is believed, in the same proportion and to the same extent as in most other countries.

Check. The credit instruments ordinarily used in the conduct of business are, however, checks and bills of exchange. The law relating to these instruments is found in the Check Act of 1897 and the Bills of Exchange Act of 1880. The Check Act is a very simple measure which prescribes that a check must have the word "check" embodied in its text, and that it must contain mention of the amount to be paid, the name of the payee, the name of the drawee, the place where payable, the date of issue, and be signed by the drawer. A check can only be made payable on demand; it may be issued to bearer and the place where issued need not be mentioned. If the check gives the amount more than once and there happens to be a discrepancy, the smaller amount will be paid. A promise for payment of interest written on a check has no legal effect. A system of certification of checks with the effect of acceptance is not known in this country, and the acceptance of a check has no legal effect whatsoever. A check may be certified by the drawee, which only implies, however, that the amount drawn for has been set aside for payment on later presentation of the check; but this does not preclude the drawee from using the amount so set aside for some other purpose and returning the check when presented. When honoring a check the drawee loses recourse to the drawer and all indorsers unless the drawee has several branch offices and honor is obtained at an

office other than the one on which the check was drawn. A crossed check is good only for deposit in a bank and may be paid only by the drawee to a bank. According to law the drawee, when having paid a check, is prohibited from indorsing or transferring it to another party. All checks and indorsements thereon are not liable to stamp duty. To prevent a float of checks the law provides that a check issued and payable in the same place must be presented for payment within three days. Other checks are to be presented within ten days. Checks drawn abroad must be presented within five days after the lapse of the time consumed in mailing the check. In case of dishonor, protest should be effected within these time limits, or what is of the same effect, the drawee should provide the check with an annotation of dishonor and mention particularly the date of first presentation. Limitation of claims takes place at the end of six months from the date of issue, or 12 months in case of checks payable outside of Europe and in Iceland and the Faroe Islands. Postdated and undated checks are subject to stamp duty at the rate applied to long bills. Failure to effect such stamping is subject to a fine of ten times the amount of stamps required. All check-clearing in this country takes place in Copenhagen. Checks on country banks are generally made payable with their Copenhagen correspondents, and all checks paid throughout the country are remitted by the country banks to their Copenhagen connections, who in turn clear the checks and settle the accounts with each other. No clearing house association exists and no official clearing takes place. No clearing figures are available and the absence of these splendid indications as to business conditions and activity which the volume of clearings gives is severely felt. Although banking facilities are within easy reach, the check habit has not been greatly developed for other than strictly business purposes.

Bill of Exchange. The Bill of Exchange can be traced back in Denmark as far as 1619 and the first act on bills of exchange was adopted in 1681. The act now in force was passed in 1880 and includes bills of exchange as well as promissory notes. The act prescribes that a bill of exchange must embody in its text the word "Veksel" (bill of exchange), the amount, the name of the payee, the name of the drawee, the place where and the time when

drawn, the place where payable in case it is payable at another place than the domicile of the drawee, and be provided with the signature of the drawer. Otherwise it is not a bill of exchange. All bills of exchange are subject to stamp duty, and if not stamped a bill of exchange becomes liable to a fine though it retains its legal effects. Regarding negotiability, recourse to the parties to the bill, indorsements, presentations, etc., the Danish Bills of Exchange Act follows the rules which are in force in all the countries that have passed the so-called German Bill of Exchange law, as distinguished from the French and the British-American groups. They are believed to be too well known to require any space here. The bill of exchange in the form of trade-acceptance is used extensively in this country. It is a practice of most wholesalers to get trade-acceptances from retailers instead of carrying open accounts.

Promissory Notes. Promissory notes are subject to all rules of the Bill of Exchange Act. And the special provision moreover applies that promissory notes must not be issued to the order of the maker. They have to give another party's name as the name of the payee.

The collection draft is an instrument very extensively used in general business transactions. It is mainly drawn on demand by the sellers on buyers who are not expected to accept but who are expected to pay on first presentation or within 8 to 14 days after first presentation. These drafts are very rarely used as credit instruments and the rules of the Bills of Exchange Act do not apply inasmuch as the words "bill of exchange" are not part of their text. Collection drafts are not liable to stamp duty, and they do not create any recourse to the parties thereto as they are supposed to be accounted for only after proper payment.

By general practice presentation of all items takes place between the hours of 10 a.m. and 3 p.m., and when maturity falls on a Sunday or a legal holiday, presentation is postponed until the following working day. It is customary to allow the drawee 24 hours to accept. The law does not provide for any days of grace, but the legal limit for protest for non-payment is two business days subsequent to the date of maturity. Protest for non-acceptance may be registered after refusal and can legally be made up to the day of maturity itself. Protest is always

necessary in case of non-payment if it is desired to retain the right of recourse against the drawer and indorsers. Legal action following protest must be instituted against the acceptor within three years from the maturity date and against the drawer and indorsers within six months. The latter limit is extended to twelve months in case the draft is payable outside of Europe or in Iceland or the Faroe Islands. As a matter of course a notation on a draft not to protest releases from the obligation to protest but not from the obligation to present the draft for payment at the proper time.

A special type of promissory note is issued by the National Bank by virtue of Section 18 of its Charter. Such promissory notes are issued payable at 8 days from date of issue for amounts not less than 1000 kroner. They are payable at the Head Office as well as at Branch Offices and are accepted by all royal offices in payment of taxes and duties to the Treasury. They are also payable in cash at such offices provided the cash-position of the office concerned warrants the payment. In addition to the commercial check, the bill of exchange, the promissory note, and the Bank promissory note, the Danish market knows of travellers' and commercial letters of credit which are issued chiefly by the big Copenhagen banks. The nature of all these documents is so exactly like those used in other countries that definitions and theories are thought to be irrelevant to this chapter.

Before leaving the subject of credit instruments it may be of interest just to turn the attention to the money market in Denmark, which is greatly influenced by the credit instruments used. It must be said at once that the market is very narrow. Purchase and sale of bills of exchange in the British or American way is unknown and acceptance- and discount-houses do not exist. There is no open market, but the method of rediscounting with the National Bank is well developed, and prior to January, 1919, the National Bank allowed commercial banks ½% rebate on the bank rate on all rediscounts.

BANKING SYSTEM

At the beginning of this section it may prove beneficial to classify and to discuss in turn the banks and institutions related thereto as follows:

1. The National Bank in Copenhagen
2. Commercial Banks
3. Savings Banks (the so-called *Sparekasser*)
4. Land Mortgage Institutions (Credit Associations and Hypothek Associations)

NATIONAL BANK. It was mentioned in the course of the discussion of the monetary system that the National Bank in Copenhagen received its charter on July 4, 1818, and was established to take over the business of the Rigsbank, especially with a view to improve the bad state of the national finances. By the Royal Charter which was granted for a period of 90 years and as from 1908 extended for 30 years, the National Bank was given an actual note-issue monopoly. The National Bank, however, was not formed as a Government Institution, but as a strictly private joint stock company endowed with certain rights, privileges, and liberties and charged with certain public duties and obligations. The heaviest duty imposed on the bank by the Charter was the establishment of safe national finances and the working towards the redemption of the depreciated note-circulation which was accomplished at the end of 27 years. This and other duties of the bank were all fulfilled with the highest regard to the public good, and so it has come that the bank, though nominally a private bank, has been increasingly regarded by the public as well as by itself as existing for the good of the Danish community in general.

Since its establishment the National Bank has functioned as a depository of government funds and acted as a central institution for the service of other private banks; it has thus obtained a kind of semi-official status, but at no time has it been in the hands of the government or even subject to the will of the government. As a matter of fact there have been times during its existence when the bank has been party to very heavy loan transactions of

the changing governments and the relations between the bank and the Treasury have been intimate. But it is only right that it should be so, for a bank of issue that would refuse credits to a government when it conclusively appeared that such credits were properly covered would undoubtedly be neglecting its unwritten duties. The central bank, although independent of a government as far as its business and general policy is concerned, would seem to be morally bound to support it, not because the bank should in any way be subordinate to the government's will, but in the interest of orderly progress of business and the promotion of trade, agriculture, and industry, which are so closely allied to the prosperity and well-being of a country and its people.

Governance of Bank. To follow the National Bank through the history of its 109 years would divert us too far. The aspects of its legal status will be found in detail in the Charter of 1818 and in subsequent legislative measures, the text of which has been translated into English by the writer of this chapter and published by the Columbia University Press under the title of *Scandinavian Banking Laws,* to which reference should be made. It will suffice to mention here that the bank is governed by a board of four or five joint general managers and a board of directors of fifteen members. Two of the managers, one of whom must be versed in agriculture, are appointed by the Crown and the others by the directors. Two of the directors are government representatives, and the others are elected by the stockholders from their midst. The Minister of Justice fills the office of Royal Bank Commissioner and as such has to see that the duties of the bank to the State and the public finances be properly observed. For its note-monopoly the bank pays to the Treasury an annual sum of 750,000 kroner, and after allocation from the fiscal profits to surplus funds and payment of up to 6% dividend to stockholders what remains is distributed in the proportion of ¼ to the Treasury and ¾ to the stockholders which may be paid out either as an extra-dividend or added to the stockholders' dividend equalization fund. Payments to the Treasury have run as high as 3,059,121 kroner for the fiscal year of 1918–1919.

Financial Statement of the Bank. As soon as possible after the end of each month the National Bank releases the consolidated statement of condition of head office and branches,

of which seven have been opened in the course of time in the most important country towns. For the purpose of analysis the statement as of November 30, 1926, is given here:

ASSETS

Loans on real estate .... Kr.	4,648,904.00
Advances and loans on mortgages	3,572,500.00
Advances and loans on securities	23,096,083.25
Railway loans to municipalities according to Act of April 10, 1895	2,146,892.99
Domestic bills of exchange	101,176,929.07
Foreign bills of exchange	72,769.65
Danish Government bonds	1,687,112.82
Other Danish securities	3,000,792.15
Foreign Government bonds	45,000.00
Balances with foreign correspondents	25,402,010.79
Demand balances with Sveriges Riksbank, Norges Bank and Reichsbank, Berlin	3,641,880.01
Gold coin and bars	209,014,256.74
Silver coin and other token-money	15,942,430.79
Sundry debtors	102,632,827.62
Joint Account of the Bank and the State	9,907,926.22
Bank premises	5,578,000.00
	Kr. 511,566,406.57

LIABILITIES

Circulation .... Kr.	377,766,592.00
Current accounts	26,633,300.85
Outstanding promissory notes	123,445.12
Deposits	161,877.81
Deposits of the Liquidation Office of 1910	374,420.48
Sundry creditors	44,517,756.74
Deposits of the Treasury in accordance with Act of April 10, 1895	2,146,982.99
Surplus (Reserve Fund)	11,340,000.00
The stockholders' dividend equalization fund	21,502,030.58
Stock Capital fully paid up	27,000,000.00
	Kr. 511,566,406.57

This statement reveals that the stock capital, privately owned, stands at 27 million kroner, unchanged since the opening of the bank. According to law this amount may be increased to 50 millions at the decision of the management with the approval of the King. The reserve fund has reached its statutory maximum and will not be further increased from profits unless depleted. The stockholders' dividend equalization fund has for a number

of years paid the 8% dividend declared. This is due to the fact that the National Bank played a very active part in the heavy bank reconstructions which will be referred to later on whereby the bank undertook obligations which not only claimed a great part of its reserves set up against contingencies but also entirely swallowed its profits for several years, and furthermore that in 1924 the bank entered into an agreement with the State in connection with a number of legislative measures for the improvement of the Danish currency, under which the bank agreed to apply the entire profits for four fiscal years to cover losses on the exchange business and the cost of the large foreign exchange credits. Now that the return to gold is definite, and the country is outgrowing the money heresies left from the War, such losses can be finally calculated, and at the end of the past year the bank fixed its entire uncovered losses at 9,907,926.22 kroner and set up amongst its assets an account called the Joint Account of the Bank and the State for that amount. The arrangement has still two more years to run and it is expected that current earnings during those years will be sufficient to eliminate that loss-account. Dividends for those two years will also be paid out of the equalization fund. "Sundry Debtors" include advances to government and commercial loans; "Sundry Creditors" include among others government deposits, and "Current Accounts" are chiefly the credit balances of other banks.

The Bank Rate. In considering the position of the bank as a Central Bank, it is important to notice that the bank itself has full control of the Bank Rate. The managers of the bank fix the rate and are bound to advise the Minister of Finance in advance when a change is contemplated. The Minister is entitled to participate in the deliberations regarding a change, but has no vote when a decision is taken. It was previously stated that an open market does not exist. The absence of bill brokers and discount houses makes the National Bank the only place for rediscounting. The rate of the bank is always the minimum rate applied to discounts and loans by other banks. Most often their rates range about 1 to 1½ per cent above the bank rate and in many cases even higher. In view of the fact that the bank is the bankers' bank and has absolute control of the note-issue, it has a rather forceful central position unless, as was in all essentials

the case during the War, there be a glut in the money market with its attendant evils and dangers. When that happened the bank lost its control of the market which then indeed witnessed strange departures in Danish banking. The weeding-out process consequent on deflation, which was sponsored first of all by the National Bank by means of rigid limitation of credit, proved to be a tremendously expensive adventure, but the conclusion may be confidently drawn, that it was also a wholesome purgative which has shown clearly that favor and benevolence are not the attributes of good banking.

Commercial Banks. In the course of the discussion of the monetary system, it was pointed out that the first Danish bank was opened as early as in 1736. Reference was also made to the vicissitudes which led to the formation in 1818 of the National Bank, which for 28 years was the only bank in the country. In 1846 the first commercial bank was established at Odense and in the early fifties the general prosperity was instrumental in the formation of about fifteen banks throughout the country. It was not until 1870, however, that the banks ceased to be the convenience of a class and became the necessity of the people. Around that time some of the banks were formed which were to become the most influential institutions fifty years later. From the fact that since 1818 the National Bank has had a note-issue monopoly, it follows that the other banks have never issued notes but have been strictly commercial in character.

Danish commercial banks are now subject to the Companies Act of September 29, 1917, as well as the Banking Act of October 4,1919. Prior to the latter date Denmark had no particular act applicable to commercial banks and no regulations existed as to the terms in which their statements of condition and profit-and-loss accounts should be rendered. For this reason the compilation of comparative statistics covering the years preceding the Banking Act becomes almost an impossibility. The line of demarcation between commercial and savings banks is rigid as is clearly brought out by the provisions of the different legislative measures which apply to the two kinds of institutions. The following are the main provisions of the Banking Act of October 4, 1919.

The Commercial Banking Code. A company which does a

commercial banking business shall be bound to and has the exclusive privilege to use the word *bank* in its name. A bank must not do any other business than commercial banking, *inter alia,* receive deposits, grant loans, receive valuables for safekeeping, purchase and sell gold and silver coin and bars, money, money representatives, credit instruments and securities, and the formation of industrial and other enterprises. However, a bank may temporarily carry on other business provided this is necessary for the liquidation of outstanding debts. The act provides for the supervision of banks by a Bank Inspector appointed by the King, and states that a bank's consolidation with or absorption of another bank or savings bank cannot take place without the consent of the Minister of Commerce and that foreign banks are not permitted to open branches without the approval of the Minister. Furthermore, no bank may open for business until its by-laws have been approved by the Minister and that amendments to by-laws also have to be submitted for approval. Moreover it was provided that the minimum capital of a bank shall be 200,000 kroner, of which at least 25% must be paid in before the bank opens and the remainder, with at least 25% annually, during the following three years. It is also prescribed that the paid-up stock-capital, with surplus funds added, must amount to not less than 10% of the total liabilities. This is the only important ratio called for by the act, and apart from this ratio no restrictions on loan operations whether to one or more customers are imposed, and there is practically no limitation upon the investments a bank may make.

Every bank must be governed by a board of directors and one or more managers. Directors and managers as well as foreign banks' business managers must be Danish citizens. A director cannot simultaneously hold office as manager, and a manager cannot hold office as manager of another commercial or savings bank. No manager of a bank may obtain loans from such bank or enter into bail for a debt to the bank without the approval in each case of the board of directors.

All banks are required to hold cash to such an amount that together with their holdings of readily marketable bills and securities it amounts to at least 15% of the liabilities which are payable on demand. No bank is permitted to buy or advance against its

own shares for more than 10% of the paid-up capital. Only with the approval of the Bank Inspector may a bank buy more than 30% of the stock capital of another bank or savings bank or make advances with a view of using the voting rights. The statements of condition of the commercial banks have to be rendered uniformly on schedules prescribed by the Minister of Commerce, and annual and monthly statements have to be rendered to the Bank Inspector on such forms. Annual and quarterly statements are to be published in certain newspapers, but generally the banks also publish their monthly statements. On the basis of the reports, the Bank Inspector and the Government Statistical Office prepare the banking statistics and these figures are available for the short period since the act was passed. The act requires that a bank which has lost its surplus and more than 50% of its capital must, without delay, hold a general meeting during which the capital structure must be reconstituted or the bank must be liquidated, unless an exemption is granted by the Minister. Notification of all such losses is to be conveyed to the Bank Inspector. In case of negligence on the part of managers, directors, or auditors to observe their duties, they incur heavy personal liability. The Banking Act became operative on October 4, 1920, and shortly afterwards the Minister of Commerce issued orders as to the forms to be used by the banks for their reports to the Bank Inspectorate and for publication purposes.

At the end of 1925 Denmark had 192 commercial banks with a paid-up capital and surplus of 477 million kroner. Of this amount the capital and surplus of the three large Copenhagen banks amounted to 265 millions and out of total resources of 3442 millions, these three banks claimed 1963 millions. To compare these figures with those of previous years does not give a good idea of the monetary situation, because they have been reached as the result of a period of extremely volcanic excitement within banking.

Relation of Commercial Banks to Denmark's Industrial Expansion. The commercial banking system of Denmark has always been a large factor in the industrial expansion of the country. The transactions of the banks were not at all confined to current trade, but often they have had large sums invested as fixed capital funds, and their functions in the investment market

(investment bankers are not known) brought them into bond and stock flotations and other operations. Quite naturally this influenced the liquidity of the banks and when the post-war boom broke, this bore down very hard on Danish banking. The partial control of industry which a number of banks possessed and the wave of private speculation which they had been fostering brought them into very dangerous tangles which, in many cases, proved fatal. The interval has seen bank liquidations and reconstructions in unprecedented volume. It reduced the total resources of the banks by more than 1000 million kroner and it wiped out entirely some of the largest banks. When, in 1922, the wave reached the largest bank of the country, the Landmandsbank, which through unparalleled expansion had come to control at that time as much as one-third of the entire banking resources, the State had to intervene, first by paying in part of a preference capital, and later, when it proved that this did not suffice, by giving an unconditional governmental guaranty for all liabilities of the bank with binding effect for a number of years. This generosity is estimated to cost the State some 170 million kroner. The reasons for such a colossal failure may be summed up in a few words: over-expansion, mismanagement, the granting of credit in an irresponsible manner. That this was permitted to go as far as it did, may be due partly to the absence during the War and post-war boom of banking legislation as well as to the characteristics of the banking system itself and the fact that price-fluctuations were so extreme in this country — one of the participating influences being the geographical position of the country, which induced merchants to overstock themselves with a view of reëxporting to Russia and the Baltic countries, a hope that did not materialize for reasons only too well known.

The Bank Statement. For the purpose of analysis of the balance sheet of a Danish bank, rendered on the basis of the form prescribed by the Minister of Commerce, the statement of condition as of September 30, 1926, of the Kjobenhavns Handelsbank, Copenhagen, one of the "big" banks, is subjoined. This balance sheet includes the accounts of the head office and nine offices in Copenhagen as well as fifteen branches throughout the country:

ASSETS

Cash ....Kr.	11,778,873.28
Banks and savings banks in Denmark	14,650,927.94
Correspondents abroad, bills in foreign currency and foreign monies	11,206,312.11
Bonds and shares	76,927,809.72
Mortgage bonds	8,808,936.18
Danish bills discounted	65,792,658.31
Loans against security	25,870,553.99
Cash credits	245,788,537.09
Current accounts	66,445,750.83
Sundry debtors	11,500,763.53
Premises	12,642,465.80
Expenses	4,181,680.49
	Kr. 555,595,269.27

LIABILITIES

Capital fully paid ....Kr.	50,000,000.00
Reserve fund	30,144,468.31
Check accounts	18,327,628.72
Current accounts	155,223,523.98
Deposits at call	59,196,603.08
Fixed deposits and deposits subject to notice of withdrawal	135,687,306.16
Banks and savings banks in Denmark	38,616,678.51
Correspondents abroad	20,036,792.10
Acceptances	613,411.97
Sundry creditors	31,674,882.34
Mortgages	3,384.00
Interest and commission	7,547,012.29
Profit and loss account	8,523,577.81
	Kr. 555,595,269.27

This statement needs but little explanation. The amount of "Cash" includes the bank's balances with the National Bank. The account called "Cash Credits" includes all standing loans, advances, and overdrafts. Proportionately this account is very high and it would seem that a much larger amount of cash would be necessary to insure the liquidity of the bank. This is not so, however, because of the fact that demand liabilities of the bank are really very small in proportion to the total. If a money market with possibilities for short investments had existed in this country, quite a percentage of the amount now carried as cash credits would instead be carried as call-loans or short bills, but the entire absence of such market makes it impossible to draw parallels with British or American conditions. "Sundry Debt-

ors " and " Sundry Creditors " include such accounts as reserves against contingencies, checks outstanding, coupons paid, collection accounts, etc. The majority of fixed deposits are carried on savings-book terms. It is rather peculiar that the check account has not yet attained great popularity in Denmark. Only a part of the accounts called " Deposits at Call " are subject to check, and the entire sum of " Fixed Deposits " may actually be considered as an investment of the surplus funds of the public. It has always been striking that the Danish public has had a liking for having surplus funds " invested " in savings accounts, and the commercial and savings banks have thus become intermediaries for reinvestment in the security market and in direct capital advances to the concerns of the country and have, in this way, come to hold over these a rather controlling position. The amount of " Interest and Commission " represents interest and commission earned since the beginning of the fiscal year. The balance of the profit-and-loss account is the balance carried forward from the previous year.

The above statement is that issued by one of the strongest Danish banks, practically the only one of the large banks which came through the period of deflation with flying colors — a period which caused one-fifth of the banks to liquidate or go through reconstruction or enter into bankruptcy. The losses of this period were borne almost entirely by the stockholders. Bankruptcy was resorted to only in a few cases, whereas in some important cases where large banks were involved governmental decrees were issued prohibiting ordinary bankruptcy proceedings and providing for the appointment of boards of administration and liquidation. In some isolated cases depositors have sustained losses, but investigation has revealed that the losses of most of the banks originated from before the time of the Bank Inspectorate, which actually brought them into the limelight, and it may therefore be confidently expected that the strict governmental supervision now in force will prove to be an excellent protection of depositors.

Unsolved Banking Problems in Denmark. The vicissitudes of banking in Denmark during the last few years have provided much material for thought and discussion, and as a result no doubt a new Banking Act will be passed. Although the wisdom of statutory control of banks cannot be denied, it seems that

the cases where the principles of good banking have been sinned against are so isolated that a new act will not need to be a drastic measure or deprive the banks of the freedom which they have so far enjoyed.

Another case which will come up for legislative treatment in the near future is the governmental guaranty for the liabilities of the Danske Landmandsbank referred to above. The guaranty still has a number of years to run, but it has previously been prescribed that in the meantime the transition of the bank to an independent bank should be prepared. This provision in its form was rather weak, inasmuch as it left it entirely to the discretion of the Minister to decide when this should start. The opposition of the other banks against a privileged State-guaranteed bank as well as by the trades and industries against the unfortunate competition of certain concerns financed by the bank has, no doubt, induced a prompt commencement of the work and results may be expected before long.

BRANCH BANKING DEVELOPMENT. Regarding branch banking, it may be said that at one time this movement was developing rapidly, the Copenhagen banks having something like 300 branch offices throughout the country. Local patriotism, latent ill-will against "money trust" and "high finance," and last but not least the troubles of the two largest banks engaged in branch banking, the Danske Andelsbank with about 115 offices, which stopped business entirely in 1925, and the Danske Landmandsbank with about 85 offices which had to go through a number of reconstructions and as a result closed many of its branches, have been obstacles to further development. Among the commercial banks there does not seem to be much coöperation, and apart from an association of provincial banks, there does not exist any association of banks or bankers in this country, not even a clearing-house association, for a clearing house does not exist either.[1] Check clearing for the whole country takes place in Copenhagen, all country banks and branch offices remitting their checks at the end of each day to their Copenhagen correspondents, who in turn clear the checks over their counters in the old way by presenting the checks directly to the drawee bank. Such presenta-

[1] Since the writing of this chapter a clearing-house has been established in Copenhagen. Clearing figures are published monthly only.

tions are effected two or three times every day, and certain rules as to return of checks for non-payment are in operation according to mutual consent among the banks.

Banking Functions. The banks pay interest on all accounts at varying rates, generally ranging at present from 1% per annum on check account to 2, 2½, 3, 3½ (on personal accounts subject to check on which 2000 kroner is the maximum which may be withdrawn within a week) to 4 and 4¼% on fixed deposits.

There are no special underwriting companies or investment bankers for the flotation of governmental, municipal, and industrial issues, and all such business is handled by the banks.

The banks are prepared to handle any type of collection business on the basis of a Joint Tariff of Charges subscribed to by all Danish banks. The larger banks have well equipped departments for trading in foreign exchange, for rendering credit reports and other special services.

Most banks conduct a commercial letter of credit business, which, however, becomes of importance only in the case of the big Copenhagen banks. This is for the purpose of financing imports. The exports mainly consist of agricultural products which are immediately ready for retail distribution as consumption goods and are therefore not conducted to any extent by means of credit. Almost all banks maintain a safekeeping service and have safe-deposit vaults.

Coöperative Banks. Denmark is without doubt the country in which coöperation has reached its highest development. Profit-sharing organizations, mutual aid societies, and coöperative undertakings have been started in one field after the other, whenever the task at hand has been too large for individual effort. In line with this great movement a coöperative bank was started just prior to the outbreak of the World War under the name of the Danske Andelsbank. The coöperative movement finds its supporters almost exclusively among the farmer element, which became the important clientele of the bank. It is a well known fact that the limited surface of Denmark is offset to a considerable degree by the scientific fashion in which agriculture is carried on, and in spite of the small size of the country, the bank therefore, in order to reach its clientele, had to enter upon a branch banking system without equal in this country, at one

time numbering about 115 offices. Its capital was subscribed by coöperative societies and undertakings and to some extent by the public. Additional capital had to be provided by a number of these societies and the National Bank when the boom-period brought the bank into troubles. This did not weather the storm, and in 1925 this departure in Danish banking closed its doors, depositors sustaining a loss of about 22 per cent. The total resources of the bank at one time exceeded 200 million kroner, but fortunately the bank's business was spread so widely over the country that its customers succeeded rather promptly in getting into connection with local banks which willingly reëstablished old connections. A few small and unimportant coöperative banks still exist, filling a local need and, keeping within their limits, they have their mission; but for a coöperative bank of ramifications like the Danske Andelsbank, the Danish banking system has no need and apparently no room.

Savings Banks. The savings banking system in Denmark is very highly developed; its origin was as early as 1810. At the present time there are about 525 savings banks with total deposits as of March 31, 1926, of 1,891,000,000 kroner on more than 1,600,000 accounts (the population of Denmark is only about 3,200,000). The savings banks of course are subject to very rigid supervision and regulation as prescribed originally in the Act of 1880 and as revised under date of October 4, 1919. The savings banks are bound to and have a monopoly to use the word *Sparekasse* (savings bank) in their name. They are under the immediate supervision of a Savings Bank Inspector appointed by the Crown. The idea of having a savings bank account has always had such a hold on the mind of the Danish population that before the War it had larger per capita savings bank balances than any other country of the northern part of Europe. For this reason the commercial banks had to maintain savings departments and offer special inducements in order to compete for the funds of the public.

The savings banks invest their funds partly in real estate loans and partly in government and municipal bonds and bonds issued by mortgage institutions, and they thus became an important intermediary between the small investor and the investment market. Except with the approval of the Savings Bank Inspec-

tor, no funds of a savings bank may be invested in shares of stock, save National Bank shares and shares the dividend of which is guaranteed by the Danish State. The Savings Banking Act prescribes that the Inspector may order the closing of a savings bank when it has sustained losses amounting to 5% of its deposits. The savings banks originally started as philanthropic institutions for the working class and they have developed to serve principally the working and middle classes, acting as important instructors in teaching such depositors to become personal investors. In developing such personal investments, especially in the bonds of credit and mortgage associations the savings banks fill a great mission. Gradually as the single depositors build up their accounts for such investments it is natural and reasonable that the securities thus purchased remain under the roof under which they came into existence, and for this purpose a number of savings banks have recently provided facilities for receiving securities for safekeeping and even safe-deposit vaults with boxes for rent.

The savings banks are spread all over the country into every county and every hamlet. Their importance in the monetary system is tremendous and they are an influential factor in between the two other factors, commercial banks and credit associations, supplementing the activities of the former and supporting the growth of the latter.

That an institution of the kind of the Hypothekbank is needed in this country might convey the idea that what is really needed is a broader investment market, and a wider development of public interest in Danish securities. It is necessary that all the institutions now described should work together towards a common goal and with that end in view instruct the public along easily accessible lines. The settled rules of banking, the laws of currency issues, the ups and downs of foreign exchange, the rise and fall of interest rates, the fluctuations in the prices of even premier securities on the Stock Exchange — all these things are not easily fathomed, but it is particularly important that Danish banking should not be unduly hampered by out-of-date conceptions; for the institutions discussed cannot thrive without good will and ready coöperation based upon mutual understanding and the completest confidence.

Credit and Hypothek Associations. Among the institutions which have been formed during the last 75 years and by means of which the country has strengthened its position and the population improved its social and economic standing to a level never dreamt of, the land and mortgage banks or Credit and Hypothek Associations, the so-called *Kreditforeninger* and *Hypothekforeninger*, have a high place. The Credit Association Act of June 20, 1850, is not without reason called one of the pillars of Danish economic life, for it brought about the formation of a number of credit associations which have successfully organized Danish real estate credit with the result that it has been able to develop upon sound lines. The credit associations depend for their extended business to a great extent upon the system of registration of all land in the Land Register, in which every plot of land is registered with a mention of all buildings, etc., standing thereon, all deeds, mortgages, and encumbrances thereon. The register is publicly accessible and it will be readily seen that it is easy on the basis of the register to establish a clear title and to obtain exact knowledge of all debts secured by a certain piece of land, and this point is of great importance inasmuch as all mortgages duly registered take preference as to security over mortgages not duly registered.

Types of Business Transacted. The associations consist generally of borrowers jointly and severally responsible for the loans obtained. The credit associations grant first mortgage loans up to 60% of the assessed value, and the mortgage associations second mortgage loans for the following 15% on the security of the borrowers' real estate. The loans are paid out by the associations in their own bonds, uncallable by the owners, but to be paid off gradually by the associations in the same proportion as the borrowers repay their loans. The associations enjoy by law a number of privileges. First of all their bonds are not subject to stamp duty and may be issued to bearer; they may make distress without judgment or arbitration, and their bonds are legalized for investment of funds belonging to minors and public foundations. Among the duties of the associations is the one that as, and when, amortization of loans take place similar amounts of bonds are drawn for repayment, and it is especially prescribed that at no time may the amount of outstanding bonds exceed that of loans outstanding. Another is the fixing of the joint liability

of the borrowers. In order to limit that joint liability and also with a view not to favor new borrowers unjustly at the expense of old borrowers (who have made regular repayments and payments to surplus account), the associations have deemed it correct to divide the borrowers in series, which close either when a maximum amount has been reached or when a certain time has elapsed and between these several series, as a rule, no joint liability exists. Such series have been formed with varying rates of interest payable on the corresponding bonds and also with different periods of amortization, the average period being 60 years. On March 31, 1925, the 13 credit associations and 9 mortgage associations had outstanding about 317,000 and about 44,000 loans respectively with original amounts of 3,312,499,000 and 354,364,000 kroner. At the same time the total amount of loans outstanding less repayments amounted to 3,498,851,000 kroner. The average size of loans advanced in recent years is shown in the table subjoined:

	Credit Associations	Mortgage Associations
1915–16	Kr. 10,500	Kr. 7,500
16–17	11,100	9,500
17–18	10,700	7,900
18–19	11,000	8,900
19–20	11,200	9,200
20–21	17,600	11,200
21–22	13,800	8,900
22–23	11,700	7,400
23–24	11,000	7,400
24–25	13,000	7,200

The aggregate amount of outstanding bonds at the end of March, 1925, was about 3,440 million kroner or 99.83 per cent of the balance of the indebtedness of the borrowers. The distribution of this amount of bonds bearing various rates of interest is shown in the following table:

3 per cent. per annum	Kr. 3,033,000
3½ " " " "	307,350,000
4 " " " "	850,337,000
4½ " " " "	1,907,768,000
5 " " " "	371,624,000
	Kr. 3,440,112,000

Mention must here be made of a special institution, the Hypothekbank, which was founded in accordance with Act of April 6, 1906, with a view to obtaining loans from abroad and thereby procure such advantages for the Danish money market which might be obtained through direct connection with foreign markets. It is the business of this institution to negotiate its loans in foreign countries, the proceeds of which it uses for the purchase in the Danish market of bonds of credit associations and bonds which are guaranteed by the State — all this with a view to influencing the market for such bonds in a favorable direction. At the end of the fiscal year of 1923–24 this institution had issued its own bonds for nearly 90 million kroner in addition to which it was working with the capital fund of 20 million kroner subscribed by the State as its working capital.

CHAPTER VII

THE BANKING SYSTEM OF FRANCE

BY

Robert J. Lemoine [1]

INTRODUCTION

Any description and analysis of the French monetary and banking system is extremely difficult to write. Especially is this true for a foreigner, since he necessarily lacks a complete understanding of all the factors involved. But even so he escapes more easily than does a Frenchman from partiality and biased tendencies. When one studies the numerous French works dealing with financial and banking questions, he cannot repress a feeling of surprise at the number which deliberately set out to defend or to attack according to preconceived ideas. Even the most objective of discussions, such as the excellent thesis of A. Thery on the establishment of credit, shows only too often an obvious sympathy or antipathy. But before going on, we believe we should explain to the reader the principal difficulties encountered in our work.

(1) Apart from the organic laws of the Bank of France, the land credit institution (Crédit Foncier), and those organizations in the field of popular or agricultural credit, there do not exist any laws regulating the organization of banks or requiring publicity relative to their activities. Certain banks, it is true, are operating under quite strict regulations, dating back to older legislation, which makes obligatory the monthly publication of a statement of their condition. On the other hand, even if banks are required to submit their statements to the commercial court, their *publication* is optional.

[1] Licencié de l'Ecole des Sciences Politiques et Sociales, University of Brussels. Translation by Granville Meixell (Columbia University), and the editors.

The result is that it is impossible to know exactly the total number of banks in France, not to speak of having any knowledge of their assets and liabilities. The absolute absence of any organic or controlling legislation renders the compilation of statistics impossible.

(2) This difficulty is not without a certain remedy because it is possible to rely on the published statements of the thirty or forty most important banks. But these statements themselves are inexact, purposely so, according to the opponents of the banks, and since no uniformity exists in their compilations, any general summary which one might compile is devoid of real meaning. Those vigorous campaigns, directed with the greatest ability, to force the banks to greater clearness in their accounts, have come into conflict with seemingly insurmountable obstacles.

(3) On account of the individualistic character of the French, politics has played a very important rôle in the collective life of France and has had an important influence on financial organization. This individualism has placed the banks of France in the very center of political passions. Those who secure profit from them give them unreserved praise. Those who believe themselves to have suffered through them, or who understand too well what an element of social stability sound banks constitute, drag them to the pillory. Indeed French banking literature contains some pamphlets which would amaze the foreign reader.

The French Parliament has reëchoed many times with passionate and unjust attacks on the banks. Occasionally grave charges have been brought against them, without the legislature deeming it necessary to remedy positive abuses. The proposed remedies of nationalization, of state supervision of banks, can not be expected, especially since the war. The press is at the service of these campaigns. Under such conditions, it is extremely difficult to form an opinion, the more so since the statements of the banks, such as are published, contribute but little to the formation of an independent judgment.

(4) In the fourth place the problem of banking is confused by certain political questions which we will summarize forthwith:

a. While French administrative life is centralized in Paris, economic forces do not flow smoothly from Paris to the provinces. There is ever present a latent conflict between Paris, " that bundle

of nerves, that boiling kettle," and Provincial France, which has resulted, from the point of view which concerns us, in a struggle between the local bank and the bank centered in Paris with branches through the country.

b. The French government, which even before the war was heavily in debt, has assiduously cultivated on the part of the citizen an inclination to place his savings in State obligations. From this has resulted the extraordinary importance of the rentier in French social life. The banks have found themselves obliged to take account of this tendency.

c. Intelligent, logical and patriotic, the Frenchman too often expects from his political negotiations with foreigners advantages which he would not demand at all in his economic relations. Not that struggle or privation are repugnant to him, but he has the habit of subordinating the economic to the political. The result is that France has tried to bring about a political hegemony, by means of her investments of capital abroad, investments which have been a source of terrible disillusionment for her and which are a drag on the activity of the French banks.

d. With regard to the possession of money, of personal or family capital, the Frenchman seems to experience a respect, an intense love, which justifies any sacrifice . . . and any deception. The middle-class Frenchman, as the press shows clearly, lives in a state of perpetual disquietude concerning the evolution of social and fiscal laws. He makes a fetish of the secrecy of his business.

The taste for speculation and enrichment encourages the efflorescence of doubtful businesses which meet with success because they promise an increase of patrimony without effort and without apparent risk. Hence the unbelievable swindles, the scandals, and, in a good many quarters, the lack of a spirit of enterprise, which is replaced by a spirit of trickery.

In considering only those peculiarities of the French people which have bearing on our researches, we must take account of the fact that we run a heavy risk of not doing them justice. But it is not our mission to mete out blame or commendation. Setting to one side the great qualities of the French people, we have laid stress on those which seem to us to render the problem of banking complex.

Moreover, the fact that in spite of the number of distinguished intellects in France, one finds so few satisfactory treatises on banking, proves that the interest of the economists in this engrossing phenomenon of contemporary life, does not exist for itself but only as it enters incidentally into the pursuit of other preoccupations.

THE FRENCH MONETARY SYSTEM

The French monetary system dates from the revolution of 1789. Though from the outset gold and silver were admitted to free coinage, it was on the silver coins alone that the number of monetary units which they represented was noted. The franc was then defined as being a certain weight of silver. The gold pieces bore merely a notation of their weight without reference to their value stated in francs. The public was not satisfied with this situation, and insisted on having coins both of gold and silver which specifically named the monetary units represented. The law of March 29, 1804, met this demand, and established the bimetallic or double standard. Gold and silver were admitted to free coinage and both metals were given unlimited legal tender power. The franc was defined as being a certain weight of silver (5 grammes 900/1000 fine). A ratio of 1 to 15½ was established as between gold and silver. From this relation it was to be inferred that the gold franc was equal at the time to 0.290327 grammes of gold, with a fineness of 900/1000.

In this brief review we cannot treat in detail of the successive variations in the relative value of gold and silver nor the circumstances which brought about the formation of the Latin Monetary Union. They have been set forth in the chapter relating to the Belgian monetary and banking system. It came about that gold alone was finally admitted to free coinage. Pure bimetallism disappeared, giving way to a system in which gold was the base and which differed from pure monometallism merely by reason of the unlimited legal tender power possessed by certain silver coins. Beginning in and subsequent to the month of August, 1914, war conditions compelled the suspension of the redemption of the notes of the Bank of France, produced a

moratorium in commercial paper and bank deposits, and brought about the closing of the stock exchanges. At the present moment France is, however, no longer under a régime of forced legal tender currency circulation.

Monetary Depreciation. France financed her war expenses by means of loans and inflation and in a rather limited degree by increases of taxation. The establishment of a great floating debt by the issue of Treasury bonds and the national defense bonds were consequences of this policy, and open to criticism, but should be judged in the light of the great difficulties with which France was obliged to contend. Among these was the fact that the richest part of her territory had been invaded.

Once the war was over France found it necessary to provide for the economic restoration of the devastated territories. She also had to face the reorganization of her industries, the payment of war pensions, and provision for social legislation called for by the workingmen's movements which ran parallel to those that developed in all the European countries. Two elements, however, tended to aggravate the position of France: the non-payment of reparations in specie up to the time when the Dawes Plan took effect and the failure to cancel the inter-Allied debts.

For some years the French budget presented a deficit and this deficit was provided for by the creation of a floating debt which from and after the first of May, 1926, increased to more than 92,000,000,000 francs if we include the advances made by the Bank of France to the Government, which alone reached the sum of 41,000,000,000 francs. The situation was highly critical in 1926 when Poincaré came to power. It was necessary for him to prepare for the legal stabilization of the franc by balancing the budget and by creating reserves of exchange; while recourse to a foreign loan was out of the question on account of the hostility of public opinion toward any further foreign borrowing. The situation resulting from non-ratification by the Parliament of the Debt Funding Treaty concluded between representatives of France and of the United States was also a complicating factor.

In the middle of July, 1926, the franc was quoted at 240 to the pound sterling. Beginning with the establishment of the Poincaré cabinet the franc, however, began to advance and in-

creased rapidly to 120 to the pound. This was brought about by selling large quantities of bills growing out of the repatriation of French capital, and by speculative operations in French currency by foreigners. In fact the advance soon took on a speculative nature and had to be repressed by the Bank of France. Upon taking power, Poincaré obtained the adoption on August 7, 1926, of a law authorizing the Bank of France to buy for more than their nominal value gold and silver coins hoarded by the public and to make direct purchases of bills of exchange on the market. On the 22nd of December of the same year the Bank began to buy at an established rate all bills presented to it and thus it acquired complete control of the market. In this way the Bank of France made itself one of the most important holders of gold in the world.

Notwithstanding the unwillingness of the French Government to borrow abroad it found itself obliged to do so in an indirect way. Thus the State guaranteed a whole series of loans in Switzerland and in Holland which had been put out by the State railroads and by private companies. Furthermore the French match monopoly entered into an agreement with the International Match Corporation which rendered it possible to pay off the American 8% loan of 1920 without infringing upon the bills held by the Bank of France. These methods were at the time sharply criticised by some theorists but the outcome appeared to vindicate Poincaré. In the year 1927 there occurred a long period of actual stabilization and of budget improvement. This stability the Bank of France was able to assure at first by the ordinary means furnished by its discount policy, but later and more particularly, by the use of the powers which were granted to it under the law of August 7, 1926, which authorized it to acquire bills against payment in notes issued by the Bank. As a matter of fact the discount policy was recognized as being a much less effective means than at other periods for use in the regulation of the capital market. The portfolio of discounts and loans at the Bank of France has been much reduced since the war and has become relatively much smaller than that held by commercial banking establishments. From the end of December, 1926, the portfolio of foreign and domestic securities did not amount to more than 4,500,000,000 francs, or in terms of dollar exchange,

to less than 900,000,000 gold francs, whereas in December, 1913, it amounted to 1,500,000,000. At the end of 1926, direct loans came to 2,000,000,000 francs (400,000,000 in gold francs) as against 772,000,000 in 1913. Thus the rôle which the Bank could perform in this situation was limited.

In the course of 1927 the rate of discount of the Bank of France was lowered three times, from 6½% to 4% (with another ½% cut on January 19, 1928); the charge for loans was reduced in a similar way from 8½% to 6%. These reductions, which were permitted by the general financial situation, were rendered necessary during the first half year by the slowing down of business and throughout the entire course of the year by the extraordinary ease of the capital market as illustrated by the very low rates of interest. On certain days the rates of discount outside the Bank even fell as low as 2%, thus leaving a margin of more than 3% between such rates and the official discount rates. Obviously under such conditions a bank of issue could hardly hope to direct or maintain its contact with the market; nor could it through the discount rate exert its influence to the best effect.

By the law of August 7, 1926, the Bank of France had been authorized to buy gold and silver hoarded by the public above their nominal values, and to purchase bills of exchange directly on the open market. The purchase of gold coin had a double advantage. It enabled the Bank of France to increase its available stock and it also mobilized an unproductive reserve of capital. Notes paid by the Bank to holders of coins which had previously been hoarded were used in a very large degree to buy State securities. Thus the great body of savings, even if not really augmented, nevertheless was much more largely placed at the disposition of the capital market and certainly tended to help in the process of cutting down the cost of money. Purchases of bills of exchange with new issues of notes also helped the bank of issue to get control of the exchange market. Its action in this field was felt up to the end of 1926. Having obtained by reason of the advance of the franc an adequate supply of bills the Bank was able to become both buyer and seller, in any amount, of pounds sterling, dollars, florins, kroner, etc., at a rate announced every day. The maintenance of the stability of exchange was rendered possible on the one hand by the return of

large quantities of French capital and on the other hand by the importation of foreign capital looking for remunerative employment. It is possible to ascertain only with difficulty the amount of bills bought by the Bank in the open market, since they appeared in the statement as " Purchases of gold, silver and of bills " (law of August 7, 1926) and in part, the greater part, under the head of " sundries " on the asset side. The two items referred to compare as follows for the close of the years 1926 and 1927.

	Purchases of Gold and Silver (Law of Aug. 7, 1926)	" Sundries "
Dec. 30, 1926	1,547,314,000 francs	5,010,078,000 francs
Dec. 29, 1927	2,373,235,000	26,550,593,000

We may consider generally that the increase of the item " Sundries " is the result almost entirely of transactions carried on in the exchange market. Supposing that to be true, exchange purchases by the bank during the year in question exceeded 22,000,000,000 francs.

We have no intention of studying the evolution of the French budget. Instead we will turn directly to the monetary reforms voted by the French Parliament on June 25, 1928. The monetary law of that date, in connection with which were adopted three agreements or conventions, constitutes the new basic statute of the Bank of France as the regulator of the money market. The essential features of this monetary law are: the return to the gold standard, with the temporary authority in the Bank to refuse to redeem its notes, except in gold ingots up to a certain weight (namely, 215,000 francs or a little more than 12 kilograms of fine gold), the establishment of the franc at its then existing value, the termination of the limits fixed by law for the issue of notes and the establishment of a definite relationship between the reserve and the demand obligations of the Bank of France, as well as, last of all, the settlement of its loans to the Government.

THE RETURN TO THE GOLD STANDARD. After terminating, in its first article, the forced circulation of the notes of the Bank of France and of the Bank of Algeria, the law of June 25 defined the new French monetary unit in the following terms: " The franc, the French monetary unit, consists of 65.5 milligrammes of

gold, 900/1000 fine." This parity renders permanent so far as practicable the rate of exchange which for the preceding 18 months had been maintained by the Bank of France. In other words the stabilization was carried through at a rate close to 124 francs for the pound sterling; or, exactly, at 124.21.

By the law of April 17, 1804, the franc represented a certain weight of silver. In a roundabout way by the adoption of a fixed standard of conversion between the two precious metals and later by limitation of the debt paying power of silver coins it came about that the French franc in the course of the 19th century approximated in practice the idea of a gold standard. As in Belgium, bimetallism and the use of silver as a base were abandoned, and the new franc is a gold unit just as is the belga. The rate of franc stabilization has been much criticized, France herself including a large party of persons who favored revalorization as well as some advocates of a plan of devaluation similar to that which had been tried in Belgium. A revalorization of the franc would inevitably have brought about a dangerous reflex influence on public finance, entailing a reduction of tax receipts, and would have reacted on the Treasury, inasmuch as the Bank of France had accumulated for its account an enormous stock of bills. A revalorization of the franc at 20% would have entailed a loss of 20% on the bills which had been bought, that is to say about 10,000,000,000 francs. Nor was this all. The revalorization of the franc would have compelled a corresponding reduction of the nominal value of gold and of foreign bills held by the Bank of France. The backing of the note circulation would have been reduced in a corresponding amount and since the fiduciary circulation had not been and could not be changed it would have been less well protected. The very success of the reform itself would have been brought into jeopardy. The debt of the Treasury would have remained very large and it would have had to pay the loss on the bills, all of the purchases of exchange having been made for the account of the State.

Those who are able to review the situation objectively and impartially can feel no doubt about the matter. They will conclude that in view of the decision to fix the value of the franc at about 125 francs to the pound, and also in view of the enormous accumulations of bills which had been made in consequence

thereof, the decision of the Bank that stabilization was indispensable and urgent represented nothing more than good sense. The great speculative movements of funds which had been caused by hesitation on the part of the government furnished a sufficient measure of the risk. The rate of stabilization having once been selected, it was possible to connect the franc with any gold money desired whether dollar or pound; but just as was the case under the Belgian law it became plain in France that the national monetary standard had to be defined in terms of a relation not to foreign coins but to a fixed weight of gold.

Provisions Relative to the Convertibility of the Notes of the Bank of France. In section 3 the law provides that: "The Bank of France is held responsible for the payment of its notes in gold to bearer on demand."

"In discharging this obligation, the Bank of France has the right to redeem its notes in gold coins having the legal tender power or in gold bars at the rate per franc of 65.5 milligrammes, 900/1000 fine."

"It has the right to make these redemptions at the head office alone and in such minimum amounts as agreed upon between the Minister of Finance and the Bank of France."

By these provisions France has adopted the gold bullion standard. The reasons for the adoption of this base for the new monetary system were summarized in the official report as follows:

"Although the adoption of the plan of redeeming the notes of the bank in gold bullion undoubtedly constitutes the only way of putting an end to monetary instability, the question might be raised whether it is desirable and possible to effect a return to the pre-war method of redemption."

"In this connection one must not fail to take account of the fact that the placing of gold coins in circulation too rapidly would merely induce a fruitless hoarding, also that people accustomed themselves during the war to a strictly paper money régime, and that this represented progress from the point of view of pure economics and from the point of view of the national welfare. At the same time the gold reserves, wholly impounded in the vaults of the Bank of France, are utilized in the best possible fashion. These considerations, weighty as they are, should not be considered as the most important. There is also a great

psychological value in reëstablishing the circulation of gold coins. Experience alone will show whether it is or is not wise, economically speaking, to place gold coins in the hands of the public. But at any rate it is certain that bank notes will not be redeemed in gold coins until definite legal sanction is given. After a time there will be demands for the fixing of types and denominations, as well as for the minting of the individual coins. Temporarily, this will be done only for the account of the Bank of France and free coinage will be reëstablished only when it will cause no inconvenience."

"Under these conditions, the note holders will not be able to demand anything but gold bullion for some time. The second paragraph of article 3 of the law gives to the Bank the right to redeem its notes at its own pleasure either in coin or in bullion. The third paragraph of the same article provides that the institution of issue shall be authorized to redeem its notes only at the head office and in such minimum amounts as determined upon in discussions with the Minister of Finance. These provisions show the care the Government took to envisage the whole economic situation in the return to gold."

These arguments will doubtless appear of small importance to many people. Gold coins in fact do not circulate within the United States nor within Great Britain, even though gold was in circulation there before the war. But it must be remembered that France has always been a country with gold coins in circulation, that the citizens adhere to that tradition and that a reform which does not provide for the redemption of bank notes in gold coins or for their circulation, in the minds of the majority of Frenchmen, is incomplete and abortive. Even so it is probable that gold coins will not circulate, no more indeed than they will be coined. Experience elsewhere would lead us to presume this.

Of more importance is the fact that France has adopted the gold bullion standard, that is, the redemption of bank notes in gold bullion. Foreign bills of exchange are not included in the reserve. France thus has clearly rejected the gold exchange standard which permits the reserve to include credits in gold standard nations, as well as actual gold. To a certain extent that system permits the erection of a double superstructure of credit on the same gold base. Belgium adopted features of both sys-

tems, the reserve consisting of 30% gold and 10% foreign credits, which gives a cover of about 35% gold at a smaller cost.

Bank Note Reserve Provisions. The regulation of 1870, which fixed a legal maximum to the paper currency, was altogether too rigid and incapable of sufficient adjustment to the requirements of the present day money markets. It has been replaced by a plan, inaugurated in Belgium in 1850, for a minimum metallic reserve against the note circulation and the demand liabilities of the Bank of France. This plan permitted a more exact proportioning of the circulation to business and trade needs. Experience in the financial crises through which France has passed in the last 14 years has proved that the fixing of a legal maximum provides no guaranty against inflation, in the first place because only the volume of bank notes is limited and not the volume of credit represented by the deposit accounts of the Bank; in the second place, because of the ease of raising the limit by Parliamentary action whether such action is warranted or not.

The reserve, consisting solely of gold bullion and gold coins, must be equal to 35% of the volume of circulating bank notes and liabilities on current account. This proportion is identical with that which exists in the Federal Reserve Banks of the United States. The reserve in Belgium, as we have seen, is 40%, of which 30% consists of specie and 10% of gold credits. As a matter of fact the National Bank of Belgium has followed, since stabilization, a policy of maintaining a reserve of more than 35% in the yellow metal.

Minting of the New Coins. The French law provides, in articles 5 to 8, for the circulation of gold and silver coins and coins of the baser metals. After a brief time, the authorities will undertake the minting of silver coins. The coinage of gold will be carried on solely for the account of the Bank of France. Free coinage will be reëstablished only after an Order in Council. By such measures France will avoid those difficulties likely to arise from a too rapid return to the free coinage of gold.

Silver coins are destined to replace the 5, 10 and 20 franc notes of the Bank of France. "The minting of these is rendered essential," according to the official report on the measure, "by the poor material of which the 5, 10 and 20 franc notes are made. Article 7 of the bill provides that these are to be completely

retired by the 31st of December, 1932, and that they will be exchanged for fractional silver coins of 5 and 10 franc denominations. Thus hard money will be substituted for a paper currency, which from all points of view will be slightly superior."

"At the end of 1927, the volume of small notes in circulation amounted to 2,775 millions of francs, or about 70 francs per capita. Article 8 provides that fractional coins to a total value of 3 billion francs may be minted. That increase over the actual amount is justified if one considers that the new coins will circulate not only in France but also within the colonies."

"The fineness of the coins of 5 and 10 franc denominations will be only 680/1000, though before the war it amounted to 900/1000 for the 5 franc pieces and to 835/1000 for the denominations of .5 franc, 1 and 2 francs. Our silver coins before the war also had the earmarks of a bimetallic system, in that they had a value almost equal to their legal power of discharging debts. At the present time, on the contrary, the silver coins appear not only as a survival of the past but as an effort to meet the basic needs of trade. The silver coins will definitely take the form of a fiduciary money, in which the face value is larger than the intrinsic value. It is known, as a matter of fact, and article 8 of the convention reiterates it, that the silver coins have the legal tender power in payments between individuals up to a maximum of only 250 francs."

"It might be well to point out that almost all the countries that have minted fractional silver coins during the past few years have adopted a relatively low fineness, in practice even lower than that of 680/1000. In two important countries, England and Germany, since 1920, coins have been minted with a fineness of 500/1000. All things considered, it has not seemed wise to adopt such a low standard of fineness to the end that there might be room for improvement in the quality of the new pieces."

During the parliamentary debates, the proposed coinage of 5 franc silver pieces was abandoned. It is well known that in Belgium a royal decree of the 26th of October, 1926, in order to replace the small Treasury notes of 5 and 20 francs in circulation at that time, provided for a circulation of fractional silver coins

to be secured by a gold-credit reserve of 40 per cent. In order to replace the token coins issued in France, during and after the war, by Chambers of Commerce, new coins of base metal are to be struck by the Government. As in Belgium, the Government will henceforth mint token coins of 2 francs, 1 franc and 50 centimes.

The Conventions Antecedent to the Law of June 25, 1928. As of the date of June 23, there are in all three antecedents to the monetary law. The first, signed by the Premier and the Governor of the Bank of France, laid down the manner in which the revaluation of the assets of the Bank should take place, which up to that time had been carried on the books of the Bank in pre-war francs. In France, as in Belgium, it has been decided that the profit arising from the revaluation of the specie should go to the State and, as in the Belgian reform, that profit has been used to repay the remainder of the ordinary advances granted the State by the Bank of France during and since the war — a balance which is almost wholly amortized.

One obligation of the State to the Bank continues: those advances granted to foreign countries, which amount to 5,930 millions of francs. A special plan has been devised to guarantee the payment of this account to the Bank. This is the purpose of article 6 of the convention between the Bank and the French Government and of the conventions entered into between the Government and the Autonomous Fund for Amortization on the one hand and the Fund and the Bank of France on the other hand. The obligations representative of the advances granted to foreign states from funds supplied by the Bank of France, namely the Russian bonds, are ultimately to be liquidated. This will constitute an additional means of bringing about a contraction on the money market. It is a wise provision, the great usefulness of which has been demonstrated by the experience of the United States and England. Nevertheless, the significance of this proposal will grow progressively less in proportion as the amortization of the Russian bonds is brought about through the instrumentality of the various revenues stipulated in article 6 of the convention between the Bank and the State. At that time the rôle of the short-term Treasury bonds will doubtless be resumed.

The Financial Statement of the Bank of France. Taking advantage of the opportunity offered by the monetary reform, the Bank made commendable changes in some of the leading items in its weekly published financial statement to render it clearer and more precise. The gold reserve, which heretofore was divided among several headings, is posted now as a single entry, which quite naturally made for a very marked increase, not only by reason of revaluation but also by reason of including the amounts of gold formerly included under the headings: " Purchases of gold, silver and foreign exchange " and " Miscellaneous assets." At the end of June, 1928, the gold reserves in coin and bullion in the new financial statement amounted to 28,935 million francs and the ratio of gold reserve to demand liabilities was 40.45 per cent.

There had been vigorous complaint, during the last few months previous to stabilization, to the effect that it was not possible to ascertain from the balance sheet of the Bank of France any notion of fluctuations in the foreign exchange holdings which were for the most part included among the " Miscellaneous assets." They have been given a conspicuous place in the new financial statement, and have been divided according to their degree of liquidity between the two entries: " Funds available at sight abroad " and " Negotiable bills (foreign)." Amounts of foreign exchange loaned, of which the Bank is not in possession for the time being, and which for that reason have not heretofore been shown among the assets, will henceforth be included in a special account for the sake of a complete record. The same amount will naturally be included as a contra-item among the liabilities under the heading: " Liabilities arising from foreign exchange loaned."

The advances of the Bank to the State from 1914 to 1925 naturally disappear from the balance sheet, as well as the " French Treasury bonds discounted for advances of the French to foreign governments " for the reasons that we have cited above.

Turning to the liabilities it has seemed best to the Bank to group those under the same captions, against which a reserve of at least 35% gold must be held, namely: notes in circulation, current accounts of the public Treasury, current accounts of the

autonomous sinking fund, current accounts payable to individuals, deposits and other demand liabilities such as interest payable on deposits, dividends to be paid, demand drafts and checks outstanding. Finally, the sum of the liabilities thus set forth in detail on the financial statement is added as a memorandum item, together with the ratio of the gold reserve to this total, so that the difference between the actual ratio as computed and the legal ratio of 35% can be seen at a glance.

All these reforms reflect credit on the Bank of France, its Governor and its officials, who have apparently played a rôle worthy of the finest traditions of central banks in their arduous labor of stabilization.

A Foreign Loan not Required. It must be stated that French stabilization did not require direct recourse to foreign credit. When, in July, 1926, the dollar had risen to 49.22 francs and the pound to 240.25 francs, it seemed to many that France would, like other countries, require foreign credits to work out of this very desperate situation. And the situation in that respect was more complicated in the case of France, since it seemed that these credits could be procured only after the settlement of the inter-Allied debts. This was one of the important factors which delayed for such a long time French monetary reform. The Government did not desire to ratify the London and Washington agreements, without at least fixing the reparations to be paid by Germany.

THE CREDIT SYSTEM

In our chapter on the Banking system of Belgium, we have given a cursory sketch of the instruments of commercial and investment credit. Belgian legislation is very strongly influenced by French, the Napoleonic Code being introduced in 1830, at the time of the declaration of independence of the country. In many respects, the regulations of the two countries resemble each other to the extent that the decrees of the court of one country constitute precedents in the other. In the matter of bankruptcy and of limited companies, reciprocity agreements exist.

The provisions of French law which differ most from the Belgian

CONDITION STATEMENT OF THE BANK OF FRANCE

(Amounts in francs)

		June 25, 1928
ASSETS		
Gold reserve (coin and bullion)		28,934,885,268.85
Silver and copper coins		233,164.27
Postal current accounts		699,822,920.51
Funds available at sight abroad		15,984,600,741.32
Foreign exchange loaned		9,777,767,643.00
Advances on gold bullion and coin		37,258,500.00
Bills:		
Commercial bills discounted in France	2,955,453,811.32	2,972,422,601.21
Commercial bills discounted abroad	16,968,789.89	
Negotiable bills bought in France		10,544,906,332.68
Negotiable bills bought abroad	10,544,906,332.68	
Advances against securities		1,846,774,369.43
Negotiable bonds of the autonomous sinking fund		5,930,000,000.00
Loans without interest to the Government (Law of June 9, 1857; convention of Mar. 29, 1878; law of June 13, 1878, extended; laws of Nov. 17, 1897, Dec. 29, 1911, Dec. 20, 1918, and June 25, 1928.)		3,200,000,000.00
Rentes earmarked for special purposes (Law of May 17, 1834; decrees of Apr. 27 and May 2, 1848; law of June 9, 1857.)		112,980,750.14
Bank buildings and equipment		219,327,419.32
Silver coins demonetized for reminting		784,824,534.42
Miscellaneous assets		1,239,422,613.32
Total		82,285,226,858.46
LIABILITIES		
Capital		182,500,000.00
Profits in addition to capital (Laws of June 9, 1857 and Nov. 17, 1897.)		272,696,110.93
Legal liquid reserves (Law of May 17, 1834; decrees of Apr. 27 and May 2, 1848; law of June 9, 1857.)		22,105,750.14
Nonliquid reserve		4,000,000.00
Demand liabilities:		
Notes in circulation		58,772,461,105.00
Current account of the Treasury	5,078,688,970.25	12,757,248,720.95
Current account of the autonomous sinking fund	1,934,117,189.24	
Other current accounts and deposits	5,471,052,901.62	
Other demand liabilities	273,389,659.84	
Liabilities arising from foreign exchange loaned		9,777,767,643.00
Miscellaneous liabilities		496,447,528.44
Total		82,285,226,858.46
Total demand liabilities	71,529,709,825.95	
Ratio of gold reserve to demand liabilities	40.45	

relate to shares issued by limited liability companies. Therefore, let us examine these in some detail, the present exposition giving us at the same time indications of the comparative legislation for banks. In fact, as in Belgium, these are governed by the laws for commercial companies and do not, except for the Bank of France and the banks for issue of notes in colonies, rest on any organic statute.

French jurisprudence and legal doctrine are divided as to regulations determining the nationality of commercial companies. However, it appears that, as in Belgium, the country where the principal establishment is located determines the nationality of the company.

Foreign companies which have not obtained the authorization to exercise their rights and to appear in court in France, can neither contract nor sue at law for the execution of any agreements or obligations contracted abroad. Likewise, they cannot establish branches in France.

A law of May 30, 1857, granted these rights to Belgian companies and authorized the government to grant this authorization to companies of certain countries, without the condition of reciprocity, by decree passed by the Council of State. A decree of August 6, 1882, granted the above-mentioned authorization to companies established within the United States.

Foreign companies established in France had not submitted, before 1907, to any formality preliminary to their establishment.

Commercial companies in France include, beside general partnerships (sociétés en nom collectif) and coöperative societies, the limited partnerships (sociétés en commandite par actions) the limited liability company (société anonyme) and the company with variable capital (société à capital variable). These three last are the most important.

The French law, of July 24, 1867, modified by various laws of which the latest is that of January 30, 1907, fixes a minimum par value for shares. When the capital is less than 200,000 francs, the shares may not be for an amount less than 25 francs, and when the capital is over 200,000 francs, shares may not be for an amount less than 100 francs. In the first case, the shares must be paid up in full at the formation of the company; in the second, they must be paid up for at least a quarter of their

amount. The shares or their subshares are negotiable after this payment, but must remain registered until they are entirely paid up. The shares remitted in payment of any assets taken over must be paid in full at the time of the formation of the company and may not be negotiated until two years after the formation. The responsibility of the shareholder lasts for two years after transfer, with regard to payments not yet called.

The organization of limited companies may be made by the filling out of a document before a notary, made in duplicate. The French law requires a minimum of seven associates. The stipulations relating to shares of " sociétés en commandite " are applicable to the shares of limited companies.

The right of the auditors of French companies is rather limited, — they may not have access to the books except during the quarter which precedes the time of the meeting of the general assembly of stockholders. Every quarter the company must transmit to the auditors a summary of its assets and liabilities. The company must also communicate to the auditors, fifteen days before the general meeting, a balance sheet containing a statement of the transferable and fixed assets and of all the assets and liabilities of the company. This is important in the case of banks, since it makes known their participations in other stock companies; however, between communication to the auditors and the publication there is a barrier which the banks generally do not overstep.

Companies with a variable capital include particularly those enterprises which are conducted by members of the same family. It may be stipulated in the statutes that the company's capital will be increased by successive payments made by the members of the company or by the admission of new members and to a reduction, by a total or partial recovery of the assets put into the business. In these companies, the capital may not be increased by the consecutive statutes of the company beyond 200,000 francs. The consecutive resolutions passed at the general meeting may not add to it more than 200,000 francs at one time. The shares or subshares of these companies remain registered permanently even after the shares are fully paid up. Negotiation can only be made by means of transfers on the register of the company and the board of directors or the general meeting may always prevent these transfers.

It is especially important for us to consider in detail the provisions of the French law in regard to the publication of the articles (actes) of a company, the publicity given them affording certain guarantees to the shareholders. By the terms of the law of July 24, 1867, the constitutive agreements of companies must be deposited in the registries of the justice of the peace and the commercial court of the place where the company is established; they must be published, in abstract form, in the newspapers designated to receive legal announcements.

But this law, as Desmaisons has remarked " regulates the relations of the stockholders with the founders and directors. It does not concern itself with the relations between buyers and issuers, that is to say, between the public and the bankers, who, whether or not they have taken part in the establishment of the company, occupy themselves principally with placing stock among their clientele." The law of January 30, 1907, seeks to remedy this situation:

" The issue, advertising, placing on sale, the introduction on the market in France of shares, debentures or securities of whatever nature of French or foreign companies will be, from the 1st of March, 1907, subject to the formalities hereafter stated:

Previous to all publicity, the issuers, vendors and underwriters must have inserted in a bulletin appended to the *Journal officiel*, in a form which will be determined by decree, a notice containing the following:

(1) The name of the company or the firm.
(2) Indication of the legislation (French or foreign) under which the company functions.
(3) The registered office of the company.
(4) The object of the company.
(5) The life of the company.
(6) The amount of authorized capital, the rate of dividend on each category of stock and the capital not paid up.
(7) The last balance sheet, certified as a true copy, or a statement of the fact that it has not as yet been drawn up.

" The amount of the funded debt already issued by the company with an enumeration of the guarantees, and, if it is a matter

of a new issue of debentures, the number as well as the value of the securities issued, the interest to be paid, the time and the conditions of repayment and the guarantees on which the new issue is based."

" It must, moreover, make mention of the profits stipulated for the benefit of the promoters and administrators, of the manager and of any other person, the assets in kind and the methods provided for the payment for these, the procedure to be followed in calling general meetings and their place of meeting.

" The issuers, promoters and vendors must be in residence in France; they will be bound to sign the notice above with name and address.

" The placards, prospectuses and circulars must reproduce the statements of the notice and contain mention of the insertion of said notice in the bulletin appended to the *Journal officiel*, with reference to the number in which it will have been published."

Moreover, for foreign companies the law of 1907 introduced certain special provisions: " All foreign companies, which undertake in France, a public issue, a placing on sale or introduction of stock, debentures or securities, of whatever nature they may be, will be bound, moreover, to publish fully its articles of association, in the French language, in the same bulletin appended to the *Journal officiel* and before any placing of securities.

It was objected that these provisions, although they remedied certain abuses, did not sufficiently protect savings, the notices being confusing and misleading.

The publicity in the bulletin of the *Journal officiel* soon ran counter to the purpose sought for by the legislature. A parliamentary document shows in a graphic way how dubious financiers took advantage of it to mislead small savings: " Indeed, after having extolled the chances for the future of their business, the large prospective dividends, the always evident possibilities of increase in value, the whole cleverly heightened by the disparagement of wholly safe securities, the salesmen, if they perceive some hesitation, get out the bulletin appended to the *Journal officiel*. They point to the proclamation relative to their company which is inserted in it and conclude: " See the state itself places our notices in the *Journal officiel*. There is a guarantee of the first order." And the small investor allows himself to be

carried away, confident because he has seen, in very large letters at the top of the supplemental Bulletin: "*Journal officiel de la République française.*" A decree of 1912 changed the title of the supplemental bulletin to "Bulletin of legal announcements required of financial companies"; and the statement was added: "The State in no way guarantees the insertions."

During the war, the regulation of the issue of foreign securities in France was further controlled by the law of May 31, 1916, containing in its first article:

"The issue, placing on sale, introduction into the French market of rente certificates, loans and other public notes of foreign governments, debentures or securities of any sort of cities, corporation or companies, French or foreign, are prohibited from the promulgation of the present law until a date fixed by a decree of the council of ministers after the cessation of hostilities." The purpose in view was to prevent the French money market from being solicited by foreigners and to reserve it for National loans. With the return of peace the restrictive regulation was cancelled in as far as it concerned French securities; it is still applied to foreign securities.[2]

THE BANKING SYSTEM

THE CENTRAL BANK — BANQUE DE FRANCE. France is one of those countries which have granted the monopoly of note issue to a single private bank: The Bank of France was founded the 28 Nivôse, year VIII of the Republic (January 18, 1800), by Napoléon Bonaparte, then first consul of the Republic.

The new bank had to undertake the issue of notes, at a time when France knew well the consequences and meaning of inflation with the Banque générale de Law (1717–1720), the Caisse d'escompte (1776–1793) and, finally, the assignats, paper money of the revolutionary State, which lost 97% of its value. Which is to say that, from its origin, the task of the bank was delicate and had to be directed with prudence.

The Bank of France had, in the beginning, a capital of 30

[2] A decree of the 10th of January, 1928, has reëstablished the free circulation of capital in France.

million francs: a part of the capital was made up of the assets of another bank which went into liquidation, the Treasury subscribed 5 million francs and the rest was subscribed by private individuals, among them Napoléon Bonaparte himself and his family as private citizens. The capital now reaches 182.5 million francs, a sum to which it has attained as a result of four successive increases.

Issue of Notes. In the beginning, the Bank of France simply received the right to issue notes. On the 14th of April, 1803, the right was made monopolistic, limited at the moment by the capital. At the same time, the government granted the necessary preliminary authorization for the establishment of banks in the several departments.

After the fall of the Empire, the Bank of France reduced its activity and abolished its branches in Rouen and Lyon, which were replaced by autonomous departmental banks, invested with the right of issue. In 1840, at the time of the renewal of the privilege, it was decided that henceforth departmental banks could be established only by law. There were at that time, six provincial banks of issue.

In 1848, during the revolution, forced currency was established in favor of the notes of the Bank of France. The local banks demanded that this privilege should be extended to them; it was granted but the total of their circulation was limited to 102 millions. But as the legal tender of the local notes was confined to a restricted territory, it became necessary to transform the local banks of issue into branches of the Bank of France, in order to assure to their notes a circulation throughout France. The departmental banks disappeared and their securities were exchanged for those of the Bank of France whose capital was increased in consequence. The forced currency was lifted in 1850.

Forced currency was decreed likewise during the Franco-Prussian war in 1870. The Bank returned to specie payments beginning in 1874, but the forced currency was not legally abolished until the first of January, 1878.

On the 5th of August, 1914, forced currency was decreed anew; but has recently been abolished by the stabilization acts of 1928.

From the point of view of metallic reserve and the limit of note issuance, the Bank of France operates under a rather special

statute, which deserves to be examined, because, on the one side, the legislature did not consider it necessary to fix a ratio between the metallic cover and the circulation and because, on the other side, it has fixed rather arbitrarily the total of the notes in circulation.

The original statutes of the year VIII stipulated on the subject of issues: "The notes shall be issued in such proportions by means of the specie reserve in the coffers of the bank and the commercial paper in its portfolio, that it should not, at any time be forced to suspend the payment of its obligations." In fact, the responsibility for maintaining the metallic reserve at a figure guaranteeing the security of the note issue was left to the directors of the Bank of France without prescribing rules which are always violated when really pressing circumstances justify non-observance of the law or of the statutes. The management of the Bank, the sense of duty of its directors, are the safeguard of the holders of the notes.

It does not appear that the legislature had at any time to repent of the latitude which it left to the board of the Bank of France in regard to the issue power. The reserve was always maintained at a high level and on the eve of the war, it exceeded 62%. If since it has dropped to 5% as a result of the forced currency and the inflation, the fault is certainly not that of the Bank.

The Revolution of 1848, in leading the government to decree the forced currency of the bank note, made it likewise take, for the first time, a measure which may justify itself in a troubled period, but the maintenance of which afterwards does not justify itself in any way economically. The amount of the issue was limited and fixed at 350 millions as a maximum. A law of August 6, 1850, repealed the decree establishing the forced currency and at the same time abolished the maximum of issue.

This latter was reëstablished the 12th of August, 1870, at the beginning of the Franco-Prussian war. From the time of the invasion of the territory by the Prussian armies, the French government proclaimed a forced currency and set the limit of issue at 1,800 millions. The subsequent events will show how the fixing of a limit is of little value economically and how it is instituted simply to calm public opinion: two days after having

been placed at 1,800 millions of francs, the limit of issue was raised to 2,400 millions, after that in 1871 and 1872 it was raised to 2,800 millions and 3,200 millions.

The incessant development of business and the increase of the metallic reserve forced the legislature to grant the Bank successive increases in the limit of issue. Although the present work is descriptive and not critical, one cannot abstain from criticizing this principle of the limit of issue left to the direction of the legislature, which, in normal times, acknowledges implicitly its incompetence by granting the Bank the increases demanded without concerning itself with the monetary situation. During the last war and in the sad period which followed it, Parliament proved its incompetence in economic affairs, in just as clear a way, in voting frequent increases in the limit of issue in order to be able to have recourse to loans from the Bank.

On the 29th of December, 1911, a law raised the maximum issue from 5,800 millions to 6,800 millions. On the 5th of August, 1914, forced currency was established and the amount of issue was raised to 12 thousand millions.

At the same time, it was settled that the limit of issue might be exceeded by a simple decree issued by the Council of State, on the proposal of the Minister of Finance. On the 17th of July, 1919, a law reëstablished the control of Parliament over the issue of notes. In 1926 the reader will remember that a law authorized the Bank of France to buy gold and exchanges against the issue of notes not before included in the issue in compliance with the legal limit.

R. G. Levy, whose scant sympathy for the interference of the State in the internal life of the central banks makes him rather severe toward the French government, expresses himself as follows on this practice of fixing the limit of issue:

" The intervention of the State does not contribute to the strength of the establishment; it adds nothing to its credit, in as much as, on the contrary, every time that a political crisis breaks out, it is the government which borrows from the Bank, and not the opposite. It violates, in a double way, the normal conditions of the existence of the Institution of issue, first in decreeing forced currency, then in assigning a maximum to the amount of notes. This limitation was not contained in the original statutes and is

not in accordance with their spirit. It was simply recommended by the directors to maintain always on hand, the quantity of specie which they consider necessary to meet easily the demands for redemption.

"For about twenty years, this limit has not ceased, moreover, to be extended (reculée) by laws passed prematurely under the pressure of events. When after the almost complete repayment of the sums which it had borrowed between 1870 and 1871, the State abolished the forced currency, it was bound logically to cut down the limit, which it had fixed for the circulation, although it allowed legal tender to the notes. . . . Why decree, as it did in 1879, a maximum of 3,200 millions, raised after to 4 thousand millions, then to $4\frac{1}{2}$ and 5 thousand millions? It was believed then that an amount had been set down, which would not be exceeded for a long time. As early as 1906, it was necessary to carry it to 5,800 millions, and if the gold in the vaults continues to increase at all, another law will have to increase anew the number of thousand millions authorized. The intervention of the government, thus, exercises itself here in an untoward fashion. It has neither comprehension, nor signification; what is it but legislation which is not founded on any scientific principles, on any *a priori* reasoning and which contents itself with bending to the contingencies of events, which it is not able to foresee or to direct?"

Authorized Operations of the Bank of France. The principles ruling the Bank of France may not be studied without taking into account their ephemeral character. A law may transform the statute of the Bank and render useless all of the explanations based on the discarded text. For that reason we shall examine the statutes of the Bank of France in their broad outlines only.

The operations of the Bank of France, outside of the issue of notes at sight and to bearer, consist of:

(1) To discount for all persons having current accounts (with the right of discount), bills of exchange, agricultural and commercial warrants and other bills of exchange to order, which have a maturity of not more than three months. The Bank admits to discount only bills of exchange to order

guaranteed by at least three well known and solvent signatures. The Bank, however, admits bills with two signatures if these are accompanied by a deed of transfer of 5% consolidated government stock or its own shares.[3]

(2) To undertake for individuals or for public or private establishments, the collection of bills which are remitted to it for collection.

(3) To receive on current account and in deposit account, without interest, sums which are paid to it by individuals and public or private establishments.

(4) To pay the drafts made on it and the personal engagements contracted at its domicile by the accounts current, up to the amount of the sums showing to their credit.

(5) To grant loans on French and colonial securities, and to open current loan accounts on the same securities.

(6) To carry on operations and make advances on ingots and foreign gold coins.

(7) To deliver, to all persons, in exchange for a payment or a previous consideration, demand drafts, circular crossed checks, or letters of credit payable equally at Paris or at the agencies of the Bank.

(8) To effect the transfer of sums paid in at Paris and in the branches and subsidiary agencies, to the profit of account holders at one of the offices of the Bank.

(9) To place at the disposal of the public, in certain branches, sections of the safes, for the safe deposit of securities, jewels, etc.

(10) To keep on deposit French and foreign securities, undertaking all the operations which this service requires.

(11) To undertake to execute on the bourses of Paris, the departments, or abroad, all stock exchange orders of its clients, and, generally, all operations concerning securities.

(12) To pay or discount, for anyone, the coupons to bearer of rentes or other securities of the French treasury; to pay, at the branches, interest on the securities of the French railway companies.

[3] Certain provisions are made on a draft, which permits the Bank to lend on its own shares or, at least, to accept them as security.

(13) To compete for the issues of French rentes and Treasury securities; to place Treasury bonds.
(14) To receive from persons having neither accounts current or deposit accounts, sums which are returned to them on the remittance of the receipt.
(15) To keep on deposit at Paris, and in some branches, diamonds and jewels.

In this long enumeration, it is obviously expedient to make a certain discrimination. The Bank of France was created, at the beginning of the 19th century, to satisfy the needs of merchants and individuals in the absence of any other bank. The new institution was forced, thus, outside of its essential operations of discount and loans on securities, outside of its trade in precious metals, corollary to its function of issue to charge itself with a series of accessory operations, such as the custody of valuables. Moreover, in a country as extended as France, and which suffered from a scarcity of credit establishments, as well as from difficulties relative to the transfer of funds, the Bank of France was forced to undertake the transfer of funds for all of France. For this reason, it established a network of branches and agencies of varying importance, destined not so much to assure it business as to permit the movements between different points in France.

At the end of 1926, the number of agencies of all kinds and connected towns reached 661, to wit:

1 central bank.
18 offices in Paris and its suburbs.
159 branches.
81 auxiliary offices.
402 attached towns (villes rattachées).

(*Report of the Bank of France for 1926*).

Discounting takes place only at the central bank and the branches. France, like the Latin countries, has a relatively important circulation of notes and had, before the war, an important metallic currency. The system of payments by check or transfer has developed only very slowly. The Bank of France, under this head, is obliged:

(1) To increase its circulation to an extent which would be dangerous in the Anglo-Saxon countries, but which is normal in France, in view of the backward development of the practices economizing in the use of money;
(2) To place at the disposition of its clients complete service in the transfer of funds;
(3) To follow, in agreement with the government, a systematic campaign in favor of the operations of clearing and transfer.

The following table will give an idea of the efforts of the Bank of France in this field.

Year	Number of clearing houses	Total movement of the funds of the Bank of France	Total of exchanges for clearing house	Per Cent of transactions settled by cancellations
1919	45	886,887	705,805	79
1920	51	1,954,796	1,344,066	86.5
1921	60	1,376,256	1,199,280	87
1922	71	1,344,744	1,148,331	85
1923	96	1,584,956	1,358,649	86
1924	113	1,994,325	1,723,219	86
1925	165	2,079,655	1,812,247	87
1926	190	2,766,615	2,455,615	89

It seems clear that the system of the clearing houses has been developed in part to counteract as much as possible the inflation of notes. It is evident that the development of the great French banks of deposit and the expansion of their branches throughout all France facilitates the diffusion of modern methods of payments by accounts, at the same time that it diminishes the burden imposed on the Bank of France by a series of unproductive operations, imposed by necessity.

Administration of the Bank of France. The administration of the Bank of France combines management by the shareholders with State control. It includes three phases:

(1) The administration of the Bank.
(2) The board of regents (directors).
(3) The general assembly of the shareholders.

The governor and two deputy governors are appointed by the President of the Republic and represent in the board of administration the executive power, with, according to the words of Napoléon, "the right of censure and opposition." The governor directs all of the business of the Bank, and alone signs, in its name, all of the contracts and agreements. He presides at all of the meetings, appoints and dismisses the staff, designates the administrators of the branches. The governor's place is taken, in case of absence, by the deputy-governors; the former must prove ownership of a hundred shares, the latter of fifty.

The general board or board of regents includes; the governor, the deputy governors, 15 regents and 3 auditors chosen among the shareholders resident in Paris. Five regents, at least, must be taken from among manufacturers and traders. In addition there must be representatives of the paying treasurers-general (high officials of the treasury department). One of the regents represents agriculture.

The general board of directors has for its powers:

(1) The superintending of all the operations of the bank.
(2) The examining of the bills of exchange presented for discount; the fixing of the rate of discount and of interest on loans.
(3) The determining of the total of the sums to be thus employed.
(4) The formulating of contracts and agreements.
(5) The issuing and withdrawing from circulation and cancelling of bank notes.
(6) The determining of the method of the investment of the reserve funds.
(7) The enforcing of the laws and statutes.
(8) The appointing of the auditors of the branches and the presenting of the annual report to the meeting of the shareholders.

The members of the board of directors are elected by the assembly of shareholders by an absolute majority of votes. The board meets once a week. A quorum consists of at least ten voters plus one auditor. The auditors, who must inspect all opera-

tions, assist at meetings of the board in a consultative capacity only.

The board of directors is divided into 7 committees: discount, bank notes, books and portfolios, reserves, relations with the Treasury, branches, and deposits.

Beside the board of directors there exists in a purely advisory capacity: the discount committee. It is composed of 12 members chosen from among the shareholders carrying on business in Paris and appointed by the auditors from a list of candidates presented by the board of directors. They are called alternately with the committee on discount and have the responsibility of examining the paper presented for discount and informing the board on the solvency of the signers. The members of the Board of discount must furnish 10 shares as security.

The general assembly of shareholders is composed of the two hundred largest shareholders, registered for at least six months and French citizens. It is called each year at the end of January and may be called for an extraordinary reason, if the number of the auditors is reduced to one, and of the regents to 12, or on demand of the auditors, approved by the board.

The shareholders choose the regents and auditors and approve of the annual report; they must vote in person and have only one vote, whatever their number of shares. The administration of the Bank of France is thus aristocratic, the rights of the shareholders are actually very limited; the board of directors (regents) settles important questions relative to discount; but in the final analysis, it is the governor and the two deputy governors who exercise the final power and have extensive authority.

The branches of the Bank of France are administered by one director appointed by the governor, and by 12 others designated by the latter from a list drawn up by the general board and in addition are supervised by three auditors appointed by the general board of the Bank.

The Relations of the Bank of France with the State. From its beginning, the Bank of France was entrusted with numerous duties on behalf of the State, and was induced to grant it loans of considerable size. We will not consider here the loans made during and after the World War. They are certainly important, as well from their amount as from the influence which they exerted on the monetary policy of France. But we have

already set forth in detail the genesis and effect of these loans. The legal stabilization of the French currency will bring with it a revaluation of the metallic reserve of which the calculable profit will certainly be given to the State, in the amortization of its debt. It is impossible to foresee whether the balance of the debt will be wiped off by the proceeds of a foreign loan, or by methodical and successive redemptions, or if it will be considered in part, at least, among the assets of the Bank as a permanent debt of the State to it.

It would also be too long to relate in detail the operations of the loans of the Bank of France to the state from 1800 to 1914. The most important loan reached about 1,530 million francs during the war of 1870, and was repaid in 1879.

At each renewal of the privilege, the government was obliged, by the bank, to consent to a permanent advance, which, in certain cases, took the place of a temporary advance which had not yet been redeemed. It is in this way that by the treaty of June 10, 1857, the Bank agreed to make advances to the state up to the sum of 80 millions, including the 55 millions which remained unpaid from the loan of 1848;[4] the agreement made with the state confirmed in this way the principle of the permanent loan which was to be amplified little by little.

The permanent loans are as follows:

60	million	francs	in	1857
80	"	"	"	1878
40	"	"	"	1896
20	"	"	"	1911
200				

The last two loans were for agricultural credit and for small commercial undertakings. It is only in the course of an evolution comparable to that which took place earlier in Belgium, that the principle of the absolute liquidity of the assets of the central bank is evolved with perfect clearness. On two different occasions, the French state believed that it could offer the Bank of France real property as guarantee for its advances.

A decree of the fifth of July, 1848, authorized the loan of 150 millions from the Bank of France, of which one-half was payable in 1849. The government insured the payment of these 75 mil-

[4] The loan of 80 millions was later reduced to 60 millions.

lions by selling 84,729 hectares of forest to the Bank which it had the right to sell. To insure the first advances consented to during the Franco-German war of 1870, the treaty of January 22, 1871, gave the Bank as a bond of security (titre de nantissement) the woods and forests of the civil list.

Without wishing to exaggerate the influence of these engagements, it is nevertheless interesting from the theoretical point of view, to record the creation of an immovable guarantee to maintain the credit of the bank note, a pledge payable to bearer and at sight.

The Bank of France fulfills the function of banker and cashier for the administration of the Treasury, denominated under the name of "General movement of the Funds." These operations included the opening of a central current account permitted to the accountants (comptables) of the Treasury:

(1) To carry out, in all the branches and auxiliary offices, the payments and appropriations necessary for the general movement of the funds;
(2) To make collection, likewise in the connected towns of the drafts remitted by them.
(3) To obtain the transportation of specie necessary to supply their offices with fractional coins.

Furthermore, the Bank is bound to weigh and to transport to the Mint, at its own expense, the light-weight coins for which the minister of finance prescribes recoinage. All these operations are made free of charge. The Bank is also burdened with various royalties to the profit of the state.

A law of June 13, 1878, instituted a tax of 0.50 francs 0/00 on the productive circulation and a tax of 0.20 francs 0/00 on the unproductive circulation. In order to calculate this tax, the general average of the circulation is divided into two parts: one represents productive operations which include the portfolio, advances on securities and on ingots or on foreign specie, and promissory notes. The balances of these four accounts are taken each day, added for the entire year, and divided by the number of working days; in this way the general average of productive circulation is obtained. The law of 1897 imposed upon the Bank of France

a tax equal to the product of $\frac{1}{8}$ of the rate multiplied by the figure for the productive circulation, with the provision that this tax should not be less than 2 millions.

The law of December 20, 1918, modified the rate and the basis. In order to calculate the royalty, the product obtained by multiplying the mean balance of the productive circulation by the rate of discount is added to the amount of interest collected on the securities extended by the moratorium, decreed at the beginning of the World War, and a proportion of 5% is taken of the total thus obtained. If during any period the rate of discount exceeds 3.50, 4 or 4.50%, this proportion, for the corresponding period, will be raised respectively to 7.50, 10 or 12.50%.

Furthermore, a supplementary royalty of 2% is taken on the product determined as indicated above, of the productive operations of the Bank, for each fiscal year after deducting the above royalty the amount included between 0 and 50 millions is only counted at $\frac{1}{4}$ of its total; between 50 and 75 millions, as $\frac{3}{8}$; between 75 and 100 millions, at 4/8, etc. . . .

Next according to the terms of article 12 of the law of 1897; "When the rate of discount exceeds 5%, the resulting proceeds shall be deducted from the dividend; one quarter shall be added to the capital, the surplus shall be returned to the state;" finally, according to the law of December 20, 1918, if the dividend exceeds 240 francs, any dividend higher than this figure obliges the Bank to pay to the state a sum equal to the amount of the net surplus distributed.

In 1926, the sums paid to the state were drawn up as follows:

General taxes and royalties	Fr.	188,807,000
Payments on amortization account	"	1,342,000
Payment to the state of a sum equal to the part of the net dividend of 320 francs exceeding 240 francs per share	"	14,600,000
	"	204,749,000
To which must be added: Voluntary contribution ..	"	20,000,000

Discount Policy of the Central Bank. The discount policy of the Bank of France is characterized by the stability and the moderation in the rate of discount which is shown by the table on the next page:

Average Rate Per Cent			
Years	France	England	Germany
1898	2.20	3.25	4.27
1899	3.06	3.76	5.04
1900	3.24	3.96	5.33
1901	3.—	3.72	4.10
1902	3.—	3.33	3.32
1903	3.—	3.75	3.84
1904	3.—	3.29	4.22
1905	3.—	3.01	3.82
1906	3.—	4.27	5.15
1907	3.47	4.93	6.03
1908	3.04	3.—	4.76
1909	3.—	3.11	3.93
1910	3.—	3.72	4.35
1911	3.14	3.47	4.40
1912	3.38	3.78	4.95
1913	4.—	4.77	5.88
1914	4.22	4.04	4.89
1915	5.—	5.—	5.—
1916	5.—	5.47	5.—
1917	5.—	5.15	5.—
1918	5.—	5.—	5.—
1919	5.—	5.15	5.—
1920	5.73	6.71	5.—
1921	5.78	6.09	5.—
1922	5.09	3.69	6.32
1923	5.—	3.49	38.82
1924	6.02	4.—	10.—
1925	6.52	4.58	9.15
1926	6.59	5.—	6.73
1927	5.23	4.65	5.84

The rates since 1914 are evidently not indicative of the normal policy of the three banks which are cited.

The Gold Reserve Policy. The Bank of France has for a long time been interested in building up a large gold reserve for itself as the following table indicates:

1900	2,334,300,000 francs
1905	2,864,300,000 "
1910	3,263,100,000 "
1914	4,158,500,000 "

The efforts made by the Bank since 1926 to buy gold must also be mentioned: the exact figure of its metallic reserves at the pres-

ent moment can only be known after the operations of reëvaluation are complete as the actual reserve includes dissimilar elements. Several years before the war, the Bank began to carry out a policy of accumulating foreign exchange which it has pushed very far since 1926.

THE BANK OF FRANCE AND THE MONEY MARKET. The Bank of France, according to Descamps (*Les Changes Étrangers*), occupies a very strong position on the French money market. "This is due to the monetary habits of the public and also . . . to the fact that it is not obliged to observe a legal or statutory proportion between the amount of its reserve and that of its circulation. . . . Finally, it mingles more directly than the Bank of England or the Bank of Germany with the movement of business.

"In the course of the last 25 years, the Bank of France has developed in very large proportions its clientèle for discount outside of the community of banks, which gives it a more decisive influence on the current rate of interest. This situation, it is true, obliges it to watch carefully what is going on both at home and abroad. Precisely because the absence of narrow limits to its issuing ability gives it a greater responsibility, because the number of parties apt to call upon its help might induce it to pass the limits beyond which the monetary equilibrium would be disturbed, it must observe attentively the many changes which occur in the movements of commerce and in international relations, in order to be able to foresee their effects.

"Nevertheless, and in spite of the fact that its control of the market is more extended, the Bank of France must also be counted among the big credit concerns whose deposits increase continually and which employ the greater part of their deposits for discounting.

"The amount of the deposits in the big credit institutions: Crédit Lyonnais, Comptoir d'Escompte, Société Générale and Crédit Industriel et Commercial, increased from 1,275 millions at the end of 1890, to 5,680 millions at the end of 1913."[5] The total of the portfolio of discounts and of advances of these same establishments, which was slightly above a thousand millions at the end of 1890, increased to 4,780 millions at the end of

[5] And to 22.4 thousand millions in 1926.

1913. In the same period, the total of the portfolio of discounts and of advances of the Bank of France scarcely doubled, increasing from 1,132 to 2,300 millions in round numbers. While, at the end of 1890, the comparison of the portfolio and of the advances of the Bank of France with the portfolio and the advances of the four credit concerns, spoken of above, showed a difference of nearly 5% *less* for the latter, at the end of 1913, the difference was nearly 108% in their *favor*."

We voluntarily abstain from all comparisons of the period after the war, because it is altogether exceptional and the movements of the portfolios of discount of all the banks of the continent have undergone an evolution tending to contract the discounts of the central banks and in a lesser degree, the private banks, and developing on the other hand, advances on current accounts. In those countries where monetary conditions have become normal again, it is evident that although the central banks may have difficulty in regaining their contact with the market, they are succeeding, nevertheless, in increasing the amount of their discounts. For the Bank of France, the portfolio of discounts, reckoned in gold, increased to 286,443,600 francs up to the 19th of January, 1928.

The Bank of France is above all, like all the central banks, a bank for rediscounting. J. Doumergue, in his book, *La Question des Sociétés de Crédit* points out one practice of the big private banks which tends to diminish the regulative rôle of the Bank of France. According to this author, the big credit establishments consider discounting as an " advertised article " to attract customers and influence them to follow their advice in the matter of investments. The discounting operations of the credit establishments give rise to rediscounting. The big banks proceed as follows: The entire portfolio collected each day by the provincial agents is sent, that same evening, to the head office in Paris. There, without other consideration, it is classified according to maturity; and it is from this common portfolio that the directors in Paris take their shortest term notes in order to supply each agency with the cash resources which it demands.

The fact that the credit societies can dip into this portfolio, collected from all points of French territory, for their shortest term notes in order to realize on them, assures the big credit

establishments of a most favorable situation, in comparison with the provincial banks which, after having been denuded of their short term paper, are obliged to encroach upon their reserves of long term paper earlier than the big concerns.

It is undeniable that the commercial banks rediscount a continually increasing proportion of their small bills of exchange. In 1912, the number of bills of exchange under 100 francs reached 27% of the total bills of exchange entered in the portfolio of the Bank of France.

We have already said that the Bank of France practiced a discount rate policy of great moderation, and that it forced itself to change the rates as seldom as possible in order to stabilize credit conditions. This doctrine is the opposite of that which wishes to make use of the rate of discount and of the control of the volume of credit in order to regulate production and prices. But the economic situation of France must be taken into account, a situation which was very stable, some say stationary, and also the profound influence of physiocratic and liberal doctrines in the country, which gained their power from the belief in the " natural course " of events rather than from an attentive observation of economic facts, and which proposed artificial and sometimes coercive methods of control.

The Bank of France could also count on bimetallism to defend its reserve. Hartley Withers, in the *Meaning of Money* presents the situation as follows: " The Bank of France is often presented as the ideal model of the international banking system, by those who consider the merits of a bank to consist in the stability of its official rate of discount. This point of view naturally attracts the chambers of commerce and the group of merchants who wish to find money primarily at a low rate, and secondarily at a stable rate.

" But the reason for the stability of the official rate of the Bank of France is that the Bank of France does not have to consider the problem of banking affairs, such as we understand them in England, that is, the immediate payment in gold of its current liabilities.

" France is still consuming the remains of bimetallism and its bank may, as a result, decide to pay its notes in gold or silver at will.

"In fact, if the demands for payment were too numerous, the Bank in order to discourage them, could offer as payment five franc pieces (écus), simple tokens, whose value as bullion is less than half of the price at which the French law allows it to give them in payment to its creditors."

The Bank benefits in fact from the right given to all debtors, in agreement with the monetary régime in use in the Latin Union, to pay its notes at will in gold coin, or in silver "écus." The écus do not risk exportation except to the countries of the Latin Union. As was noticed by Professor Ansiaux in 1910, "this latter eventuality scarcely ever occurred, as the exchange in Italy, Belgium and Switzerland was generally favorable to France." This policy was further enforced by the payment, sometimes imposed by the Bank of France, of a premium on the gold ingots which were remitted in exchange for notes.

The Gold Premium Policy. Professor Ansiaux, who has studied the question closely, describes the operation as follows in his *Principes de la politique régulatrice des changes:*

"Authorized by law to refuse payment of notes in gold, the Bank of France does not make use systematically of this rigorous right. It can even be said that it has never absolutely forced payment in silver on the holders of notes. Only, in moments when the gold reserve appeared to be threatened, it placed, during a certain number of years, the following alternatives before the holders of notes: either écus at par or gold bullion subject to the collection of a premium which was variable. The premium was never directly collected on French gold coin. . . . Neither were they supplied with it *at par:* only bullion *at a premium* was offered. This premium rose sometimes to 7 and 8 p.m. which would have been impossible if, on the other hand, the Bank had given national gold coin at par without limiting the quantity; these practices have always been quite arbitrary."

These facts were confirmed by Arnauné. The inconveniences of this policy led the Bank to give up collection of the premium in 1897, which raised the *gold point* from the start and the currency of foreign exchanges. The collection of the premium on ingots entailed another unfortunate consequence: the draining of gold from circulation. For this drainage, interested persons paid a slight commission to stockholders, who addressed themselves to the

railroad companies, to the hotels, to the stores. The prices collected were weighed and only standard weight coins were furnished to exporters; light coins were thrown back into circulation, which in the last analysis debased the national currency, as much from the qualitative as from the quantitative point of view. As, at this period, the Bank of France could not print 20 franc notes, it was at the same time forced to make up the deficiency in the circulation at the expense of the reserve which it had made a point of guarding.

Assisting Other Money Markets. At the beginning of the century, the Bank of France also inaugurated an interesting policy of regulating its rate of discount; this consisted in relieving the international money market and especially the market of London. "This method," writes Professor Ansiaux, "does not aim directly to defend the par of exchange and still less of the reserve. Its aim is to prevent monetary tension abroad. In this way, counter attacks, which might have taken place on the Paris market were prevented, and French industry and commerce was able to profit from a moderate discount rate even in periods of crisis."

This method consists in the sending of gold to the Bank of England in exchange for a portfolio of English commercial securities endorsed by this bank. As the reserve of the Bank of England was thus reënforced it could refrain from raising the Bank rate and in this way the international struggle for gold was lessened.

In 1890, the Bank of France advanced 75 millions gold to the Bank of England, after the debâcle of the Baring firm. In 1906, a new advance of 75 millions, guaranteed by English paper, was granted. A similar operation was carried out in 1907, at the time of the American crisis. The United States had appealed to England in order to obtain the necessary funds. As the monetary shortage was making itself felt in London also, the Bank of France sent gold. As the demands of New York became more pressing, the Bank of France raised its rate of discount and put at the disposal of the Bank of England, a sum of 80 millions in American gold coin, which was destined for New York.

Let us recall also the sending of gold to London during the war as guarantee for the opening of credit advances. These

" loans " proceeded from the same principle as the operations spoken of above: to strengthen the international money market in order to obtain, indirectly and directly, a stronger support.

According to the English authors, the policy of the Bank of France in sending gold to London, was less voluntary than was claimed by the French. Let us quote here Hartley Withers:

" During the last quarter of 1907, when the American crisis had provoked an exceptional tension in the money markets of the world, the Bank of England faced the situation and prepared itself to pay all demands coming from America and to strengthen itself by raising its rate of discount and attracting gold from other centers. The resolution which it showed ended by forcing the Bank of France to take its part of the international burden and to send 3 million pounds of its gold, not to America, but to London whence it could be certain to see them return. It has been commonly claimed that the Bank of England requested the Bank of France to do this. But that is quite inexact. The entire combination was arranged outside of the Bank of England, which approved it, but did not ask for it in any way. The Bank of France made an excellent and profitable investment in pounds sterling and helped to calm a storm which threatened the French monetary community with disagreeable consequences."

The Foreign Bill Policy. Until 1909, the Bank of France had not practiced the policy of accumulating foreign exchanges. It decided at this time to build up a portfolio of foreign securities, especially of bills drawn on England. But, according to Professor Ansiaux, it is not certain that it had any other aim in acting in this way, but that of making use of superabundant resources which, without this, would have remained unproductive. It is known that, since 1926, the Bank of France has bought a considerable portfolio of foreign bills which will enable it to fulfill its monetary function, as France passes to the *Gold exchange standard*.

Summary of Credit and Monetary Policy of Bank of France. It seems that the monetary policy of the Bank of France can be characterized in the following manner:

Operating in a foreign creditor country, whose affairs were not as active as in the big industrial countries, the Bank of France practiced a consistent policy of cheap money. It was assisted in

this by bimetallism, but only to a slight degree, and it gave up these questionable advantages before the twentieth century. It based its policy, from this time on, on shipments of gold abroad in times of international money tension and, towards 1910, it engaged in a policy of accumulating a portfolio of foreign bills of exchange. Like all central banks, the Bank of France saw its regulative rôle interfered with by the independent action of the private banks which had large deposits at their disposal. The Bank of France was developing in surroundings different from those of Germany, England and the United States. Every criticism of the moderate policy of the Bank of France must take this into consideration.

THE LARGE BANKS AND THE MONEY MARKET. There does not exist in Paris, a money market having an organization comparable to that of London and New York. French banks are not accustomed to obtain money at sight in order to cover their short term engagements and they refuse to put bills of exchange bearing their signature into circulation. Each bank tries to find for itself the necessary remedy in a time of shortness or abundance of money. Compensation or clearance between the different banks has been handled until now by the exchange of short term Treasury bonds and bonds for the National Defense. But as this system held certain dangers for the finances of the State, the policy of the French government tended to suppress short term bonds. The suppression of these bonds will have a certain effect on the employment of the liquid capital of the banks. Just what this is, will be seen in the rest of this chapter.

The money transactions are carried on chiefly in the morning, in the offices of the bank, and the payment of balances takes place at the Bourse, where with the exception of the big French banks and banking houses, all the branches of the foreign banks are gathered together.

The market is divided into two parts: the market for money at sight, and that for private discount.

The formalities required by the French law make loans at sight against engagements or remittance of securities impossible. Usually, the borrowing bank gives to the other a check on the Bank of France. As this procedure is not absolutely regular, the greater part of the big banks do not take part in it; furthermore,

they avoid having recourse to this method, so as not to allow it to be supposed that they are short of liquid funds. The rate of money at sight in Paris is therefore not an absolutely characteristic index of the state of the money market.

The traffic in private discount is carried on through the agency of "brokers" who, contrary to the London "bill-brokers," receive no *del credere* commission. Private discount must always be based on an operation growing out of a sale of merchandise and its duration is from 45 to 90 days. As buyers of private discount we find: the big banks, the "haute banque," i.e., large private banks, the foreign banks, the railroad companies and some important industrial and commercial firms, either directly or through the medium of private bankers. The activity of this market is rather slight nor has the rate of discount outside of the bank the same symptomatic significance in France that it has in other countries. It depends chiefly on the confidence inspired by the signatures. French bankers are tempted to consider money rates as a sort of professional secret and they are always opposed to their publication in the French press; however, the London *Times* publishes each day in the "*City Notes*," the money rates of the Paris market.

The recent economic crisis resulted in the diminution of the number of bills of exchange and restricted greatly the need for credit.

The modification of the policy of the State towards the floating debt has thus removed from the banks an easy means of investment for their available holdings. This development is clarified by the table following, which consolidates the data given in the monthly reports published by the four big banks for deposit (Crédit Lyonnais, Comptoir National d'Escompte, Société Générale, Crédit Commercial et Industriel):

These monthly statements give but little information, as the banks try to throw the least possible light on their operations. Certain headings include things essentially different: thus on the one hand Bills of exchange and National Defense Bonds are not separated, and on the other the cash holdings in the Treasury, in the bank of issue and in the other banks are not separated. The preceding picture can therefore indicate only the tendency of the development which has taken place. The first striking fact

Date		Monthly position of the four banks for deposit				Money market rates	
	Holdings in reserve and in bank	Bills of Exchange and National Defense bonds	Advances and carry overs	Debtors	Deposits and creditors	Private discount (monthly averages)	Call money
		(in millions of francs)					
1924 31 Dec.	1943	10176	1024	3295	14853	...	...
1925 31 Dec.	3111	13841	923	3704	19943	...	...
1926 31 Dec.	3615	15405	775	4455	22469	5½	5
1927 31 Jan.	3326	15697	799	4429	22760	5⅛	5
1927 28 Feb.	4318	15537	845	4569	23658	4¼	4¾
1927 31 March	6475	15173	894	4258	25159	4	4¼
1927 30 April	6581	14598	1052	4002	24637	3¼	3¼
1927 30 April*	3552	9858	738	2540	15670	...	...
1927 31 May*	5644	7877	873	2452	15768	2¼	3
1927 30 June	.....	......	.....	.....	......	2⅛	3

* Without the Société Générale

which it shows is the great diminution of the heading " Bills of exchange and National Defense Bonds " which took place chiefly in the month of May, when the three months' Bonds were due. The item " Reserve and holdings in bank " increased by 3 thousand millions, that is, about 83%. The account " Deposits and Creditors " increased 10%, while the item " Debtors," that is credit advances to private business, decreased. The banks thus saw their available capital increase largely, while at the same time, they had fewer possibilities of investment. In order to remedy this situation, we have seen that they increased their deposits with the Treasury. But if it makes no great difference to the Treasury if the floating debt take the form of Bonds or credits, it is by no means the same thing for the banks, which suffer from the point of view of the ability of their funds to render adequate income.

The banks have tried to develop other forms of credit, such as credits on the Bourse, as is shown by the increase in the item " Advances and carry overs."

Recently, the Bank of France suggested the organization of a regular money market, to take the place of the existing system.

The banks did not rally to this call. According to information taken from the *Frankfurter Zeitung* they even asked the Minister of Finance to use his influence with the Institution of issue to block the reform.

The Central Banks of the French Colonies. France has an important colonial empire in Africa, in Asia, even in America, and in the Caribbean Sea. She has been obliged to assure a money system to her possessions and to create for this purpose seven banks with the power to issue notes, to which must be added the Bank of the State of Morocco, an international institution over which French influence predominates because of the protectorate of the Republic over the empire of the Charif, and the Bank of Syria, which is a territory under a French mandate.

The chief office of the Bank of the State of Morocco and that of the Bank of Syria is at Paris. The Bank of Syria has taken over the agencies of the Imperial Ottoman Bank in the territories under the French mandate.

The Bank of Indo-China is the only one of the banks empowered to issue notes in the French colonies, which issues notes in a currency other than francs.

With the exception of the Bank of Algeria, which occupies a unique position, greatly influenced by that of the Bank of France, the different banks of issue of the French colonies send an account of their operations each year to an official at Paris who holds the title of "Central Agent of the banks of the colonies." The central agent, appointed by the Minister of the Navy, represents the banks in the metropolis and acts as their representative, as much in regard to public powers as to the supervision of the metropolitan bank, which is their correspondent, and holds in pledge the securities which represent in whole or in part their capital and their reserves.

A board for the supervision of the banks of the colonies is established in connection with the Minister of the Colonies. It includes members appointed by him, by the Minister of Finance and by the general board of the Bank of France.

These banks possess, in their respective colonies, the exclusive privilege of issuing bank notes in denominations which may not be less than 5 francs in value, up to, in some cases, three times their metallic reserve. The Bank of Algeria, like the Bank of

France, is subject to a limitation of issue, without reference to other items of the balance sheet. There is no legal proportion between the reserve and the circulation of this bank. In normal times, the notes are legal tender. The war imposed a forced currency. These banks may discount bills of exchange with two solvent signatures and for 90 or 120 days, plus the delays of distance. The second signature may be replaced by bills of lading, warrants (dock or warehouse) or by liens on standing crops. This last guarantee is altogether characteristic of the banks of the French colonies, since the colonial banks grant advances chiefly on colonial products.

Among these banks of issue are:

(1) The Bank of Algeria.
(2) The "French colonial Banks": Banks of Guadeloupe, of Guiana, of Martinique, of Réunion;
(3) The Bank of Indo-China and the Bank of West Africa.

The Bank of Algeria was established in 1851 and given the privilege of issuing notes which were legal tender only in the territory of Algeria. In the same way as the "Colonial Banks," properly so called, its reserve at first had to be maintained at 33⅓% of circulation; later, its statutes were modeled on those of the Bank of France and the rules governing its powers of issue were modified as indicated above.

In reality, the Bank of Algeria resembles the type of a European central bank more than that of a colonial bank. Its principal office is in Paris. Its capital amounts to 25 millions of which one half must consist of French securities. It is administered by a Director General and an assistant director general appointed by the President of the French Republic, by 9 directors and 3 auditors, chosen and appointed by the general assembly of the stockholders. The Director General is located in Paris and the assistant director general directs the operations of the Bank at Algiers. All the directors of the bank must be French.

The branches of the Bank of Algeria are administered like those of the Bank of France. The authorized operations are the same as for the latter, except that bills of exchange may have but two signatures and that the Bank of Algeria is authorized "to open,

with the approval of the minister of Finance, all subscriptions concerning either public or other loans or the organization of any limited liability companies with the reservation that these subscriptions will amount to no more than one third."

As a consequence of irregular discounting transactions, the Bank of Algeria had acquired, from 1880 to 1890, a portfolio of agricultural bills which were, in reality, irrecoverable, since the bank had, in the period from 1880–1886, opened credits to the colonists for the development of their property. After 1886, the bank began to redeem its portfolio and gained a very strong position. During the war, it was induced to grant loans to the State, but for relatively unimportant sums if they are compared with the advances of the Bank of France. In 1904, the Bey of Tunis authorized the Bank of Algeria to establish itself in the territory of Tunis and made its notes legal tender. Those which circulate in Tunis are given a special stamp and are redeemable in gold, while, normally, the notes circulating in Algeria are redeemable in either gold or silver, as Algeria has the same monetary régime as France. The bank agreed to make a certain advance to the treasury of Tunis and pays it certain royalties.

It should be noted that, before the war, the monetary situation of the Bank of Algeria was precarious: on the one hand, it had to import large quantities of " écus " into Algeria each year, (about 6 millions a year) in order to meet the demands of African circulation. On the other hand, the French established in Algeria invested largely in France, because of the abundance of capital in Africa. It was, therefore, difficult for the bank to keep the exchange at par. It was done in this way: Algerians who had payments to make in France either for the purchase of merchandise imported into Africa, or in order that funds might be sent to them, addressed themselves to Agents of the Public Treasury who, in exchange for their payments in notes or in specie, gave them money orders on France minus a commission of ½ of 1%. " To sum up," writes R. G. Levy, " the French Treasury fills the position of banker more than the Bank of Algeria in regard to specie; it does this without difficulty because it has at its disposal all its reserve in France, from which it takes the counterpart of the sums which it receives from the other side of the Mediterranean. On the other hand, the Bank of Algeria has not ordinarily the

same resources at Paris and would not be able to deliver at its wickets money orders on France to all those who would ask for them."

The four "Colonial banks," properly so-called, date from the abolition of slavery in the colonies in which they operate. Following the law of 1849, according to Kaufmann, 1/8 of the indemnity allowed to the planters for the abolition of slavery was to be retained in the form of rente certificates and was to be used for the establishment of a bank for discounting and loans. Public subscription to the stock was unfruitful because of the indifference of the public. In this way, the capital consisted not of specie but of rente certificates, in exchange for which the holders of the indemnity received stock in the Bank.

Each one of the colonial banks was a distinct limited liability company with its headquarters and administration in the colonies of Martinique, Guadeloupe, Réunion, and Guiana.

The capital is three million francs for the first three banks and 600,000 francs for the fourth. The executive power of the Republic and the stockholders united to appoint the directors of these banks: the President of the Republic appoints the Director, the stockholders appoint the board of directors, one of the auditors is appointed by the minister of the Colonies and the other by the stockholders. A Commissioner of the Government who is the paying-Treasurer of the colonies supervises operations.

The Bank of France prints the notes for these colonial banks which possess the legal tender power. The amount of notes in circulation may, in no case, exceed three times the metallic reserve. The total amount of notes in circulation, of current accounts and other liabilities of the bank may not exceed three times the corporate capital and the reserve funds.

The Bank of West Africa, established in 1901, absorbed the Bank of Sénégal established in 1856, on the model of the French "Colonial banks." The Statutes of the Bank of West Africa differ considerably from those of the "colonial banks," properly so-called. Its head office is in Paris. It has branches at Konakry, Porto-Novo, Grand-Bassam, Dakar and Duala, and two agencies, at St. Louis and at Rufisque. The creation of branches and agencies in foreign countries is subject to the authorization of the Min-

ister of foreign affairs. In the colonies and the countries under a French protectorate, where it has agencies, the Bank of West Africa enjoys the exclusive privilege of issuing notes which are legal tender. The amount of notes in circulation from each branch may not exceed three times its metallic reserve. The total amount of notes in circulation, of current accounts and of other liabilities of the bank may not exceed three times the corporate capital and the reserves. The 5 franc notes issued by the Bank of West Africa, are very much sought after by the natives.

The last issue bank functioning in a French colony, whose operations we shall study, is the most interesting because circumstances have forced it to play a very active monetary rôle. The Bank of Indo-China has its head office in Paris and has the exclusive right of issue in the French colonies and protectorates in which it has been allowed to establish itself. It has a circulation which consists, all together, of notes in denomination of francs, rupees and piastres. This was given the attributes of a forced currency from March 27, 1920, to January 1, 1922, because of the bank's lowered reserves. The bank has, at the present time, 20 offices in the Orient, in French India, in Siam, in English India, in China, in New Caledonia, in Russian Siberia, in Tahiti and in Djibouti; these are: Saïgon, Naïphong, Pondichéry, Nouméa, Papeete, Djibouti, Hanoi, Pnom Penh, Tourane, Hongkong, Bangkok, Shanghai, Hankéou, Canton, Battambang, Pekin, Tien-Tsin, Vladivostok, Mogtze, Yunnanfou.

It was in 1875 that the Bank of Indo-China was established by the large French banks: Crédit Lyonnais, Société Générale de Paris, Comptoir National d'Escompte, Crédit Industriel, Banque de Paris et des Pays-Bas. It had, therefore, from the beginning, strong capitalistic leanings and the representatives of the institutions which founded it still figure on its board. Its capital is 72 millions in shares of 500 francs, paid up at 475 francs only, so that they might not be transformed into bearer shares.

Its statutes were promulgated by decree and every modification must be made in the same way, so that the French government is able to exercise real control over it.

The general assembly has a plutocratic type organization; consisting of the 100 principal French stockholders. As in the case

of the other banks operating in the colonies, its notes are legal tender, but only within the region controlled by the branch which issues them. The reserve is established by the branch though the circulation may not exceed three times the metallic reserve. The amount of the notes, current accounts and other liabilities may not exceed three times the capital and the reserves.

The principal activity of the Bank of Indo-China consists in discounting bills of exchange which originate in maritime and local commerce to the interior of the colonies and between the different countries of Oriental Asia under French influence, and to China. At the same time, it undertakes the collection of bills of exchange of every kind from Europe on Oriental Asia and vice-versa, and carries on operations with precious metals. It makes advances on raw native products and on merchandise imported from Europe, commission business, etc.

Natives and French colonists may obtain loans from this institution on standing crops, estimated according to the extent and nature of the growth, the condition of the plantations, etc. "This part of the activity of the bank," writes R. G. Levy, "is carried on through the vote of the administration which receives instructions from the Governor on the subject. Loans agreed to under the guarantee of the administration for native affairs were generally at the rate of 12% a year, which was a relief for the Asiatics, who were accustomed to paying 30 and 40% to the Chinese. They offered the guarantor only a risk of a certain delay; for there were methods of making the farmers pay. The rate, in 1899, was brought down to 8%; the Bank of Indo-China cedes back 2% to the administration."

The activity of the bank is as vigorous as that of the German and English overseas banks; it is able to compete with them because of its policy of accepting overdraft deposits and of participating in the founding of financial, commercial and industrial enterprises abroad.

According to Kaufmann, besides its French clientèle, "the Bank has Belgian, Italian and even German (from Hamburg) customers."

"Not only does the Bank take part in the founding and launching of transportation enterprises in the sphere of French influence and participate in the issue of colonial loans and loans for the

protectorate of Indo-China, which it realizes with the help of the syndicate of the big banks, but it is interested also in Chinese financial affairs.

" It is at the head of the French group which forms part of the International syndicate to finance the railroads of Hankow-Canton and Hankow-Sketschouan."

The Bank of Indo-China before the war, borrowed funds directly in France at a very low rate and made use of them in Oriental Asia at a very high rate.

An important problem which faced the Bank, before the war, was that of the decline in the price of silver. The capital had been in gold in France, but the Bank had been obliged to transfer a part of it to its branches and change it there into silver, the only metal used in transactions in the Far-East. In 1892, the depreciation of silver forced the Bank to a considerable amortization. The value of the piastre fell in 1875 from 5.50 to 2.23. In one year, the difference between the highest rate and the lowest had been 17%. The Bank of Indo-China wished, at this moment, to introduce the gold exchange standard into Indo-China, as in British India; but the trade of this country is largely tributary to Hong Kong and Singapore and depends on their money system. Furthermore, Indo-China owes considerable sums to France, which are on the current account of the Treasury in the branch of the Bank of Indo-China at Saïgon; a situation which injures economic conditions in the country and influences exchange.

THE GREAT CREDIT ESTABLISHMENTS.

The order adopted here, a classification of the French banks according to their importance, is in conformity with the tradition followed by all who have studied the banking question in France; it is imposed by self-evident economic reasons: the term *" grands établissements de crédit "* includes, according to the periods studied, three, four, or five banks of deposit, organized in the form of joint stock companies, with many branches extremely centralized, which, by their own resources and the deposits which they attract, by the influence which they exert on commerce and

credit in France, hold a position comparable, in certain respects, to that of the " Big Five " in England.

The " large credit establishments," considered as such, according to different authors, are as follows:

1. Kaufmann (1910)	Crédit Lyonnais Société Générale (to encourage the development of commerce and industry in France) Comptoir National d'Escompte de Paris
2. Lysis (1907)	Crédit Lyonnais Société Générale Comptoir National d'Escompte de Paris Crédit industriel et commercial
3. André Théry (1921)	Crédit Lyonnais Société Générale Comptoir National d'Escompte Crédit industriel et commercial Banque Nationale de crédit (established in 1913)
4. Jean Loriot (1927)	Crédit Lyonnais Société Générale Comptoir National d'Escompte Crédit industriel et commercial

In general, the last classification is adopted, although that of Théry is justified by the importance of the Banque Nationale de Crédit.

As we have shown, there is no specific banking law in France; the general laws for commercial companies are applicable to joint-stock banks; the profession of banker is absolutely free. The result is that they may be organized with perfect freedom, establish as many branches as they desire, receive deposits without limit and without guarantee and deal in all operations relative to the commerce of capital and money, except the issue of notes payable to bearer on demand. Legal projects aiming to regulate the activity of banks and the profession of banker have never been lacking, but the proponents have never pushed any reform through to completion.

In France, there is not the division of function among the different banks that there is in England. On the other hand, the French banks, especially the most powerful ones, are not like similar institutions in Germany, institutions which " do every-

thing " nor have they as great a multiplicity of departments. The relation between banks and industries in France is far less close than in Germany.

It is difficult to define the precise limits of the activity of the big deposit banks or " establishments of credit." No law determines these, and sources of information are few and insufficient. The liquidators of the first Comptoir d'Escompte de Paris, in their report to the stockholders, wrote as follows on this subject: " the reports of the great limited banking or credit companies contain only such information as it is absolutely impossible to leave out or to leave uncalculated. Those things which it would be most interesting to know and which must influence the future of the company and of its stockholders, remain the secret of the board of directors and of the management." The balance sheets are obscure, as each bank prepares them on a different plan which it modifies at will. In the balance sheet the most dissimilar items are united. It is in this way, according to Kaufmann, that the Crédit Lyonnais mixes carry overs and advances, and conceals the syndical participations in the account " advances on securities." In general, the item " demand and sundry accounts " contains the most disparate elements. At times, certain banks suppress it altogether. Before the war, lively discussions were held on the subject of the systematic mystery with which the big French banks surrounded their balance sheets. *Lysis,* a very well-informed controversialist, who led a sensational campaign against the " financial oligarchy," studied this reticence of the " credit establishments " at length, and after studying the incriminating balance sheets, and allowing for exaggerations of his style, one is obliged to give weight to his criticisms. He says on this point: " We are ignorant of the most essential things, we do not know what part of the assets is realizable, what part is not, what the portfolio of one thousand million contains (if it be question of the Crédit Lyonnais), if it is exclusively commercial paper, or if it does not also contain stocks and bonds, whether this commercial paper is discountable; in what proportion it is or is not, if the stocks and bonds are negotiable, of what kind they are and what is their value. We know nothing about all these things." And Lysis quotes a statement of one of the directors general of the Crédit Lyonnais, in which he refuses to indicate the mortgages

placed in 1920. ". . . . all the credit establishments are subject to very heavy taxes, and it would not be wise to make their figures public." And Lysis adds, not without reason: "It is evident that in order to escape supervision, our credit establishments make use of whatever means come to their hands. Do they not even dare to use as an argument their intention to defraud the fiscal laws, and to avoid the payment of taxes?"

Activity of Great Credit Institutions. These details are necessary to enable the reader to realize the difficulty of obtaining information of a scientific order and to reach a conclusion based on precise facts and not on impressions. We shall now examine hastily the operations of the great credit institutions.

In considering the activity of these institutions, we must distinguish between credit operations, in the narrow sense of the term where the banks are either lenders or borrowers, and operations made on the basis of commissions which include financing and investments.

The circulation of notes was very extensive in France before the war, because the public preferred banknotes to coinage, and the check and the clearing system were not well developed. Since then the growth of deposits in the banks has been at a slower rate than in England or Germany. The interest on money placed on deposit was very low and was not influenced by the market rate. Kaufmann gives the following explanation of this condition: "The French financial establishments do not follow closely the variations of the rate on the financial market; they differ in this respect from similar English and German establishments. In any case, they cannot give their customers less than ½%, otherwise a considerable part of the deposits would be transferred to the Bank of France. The rate of interest is never directly influenced by a hardness in the financial market, as this is not usually of long duration. Moreover, some of the great banks invariably and with ease come to agreements to keep it at the same level. On the eve of the great war, the big banks handled up to 88% of the money on deposit."

Commercial Portfolio. Discounting held an important place in the active business of the great French banks before the war: in 1909, it absorbed 53.9% of the productive capital.

With all the reservations made above, we present below the commercial portfolio of the five big French banks in December, 1913.

	(In millions of francs)
Crédit Lyonnais	1,518
Société Générale	971
Comptoir National d'Escompte	1,004
Credit industriel & commercial	142
Banque Nationale de Crédit	75
Total	3,710

It is impossible to distinguish in these totals between the bills discounted, and those in the process of collection.

The average French commercial portfolio for the years 1908 to 1912 is as follows:

Bank of France	1 billion
4 great credit establishments	3 billions
Other portfolios	4 billions
	8 billions

It is known that the Bank of France is bound to adhere to a single rate of discount and does not have the right to discount bills with two signatures except in those cases when the third signature has been replaced by a hypothecation. This arrangement allows the large credit establishments to obtain a sufficient volume of discounts at a rate permitting an appreciable profit, as most of the bills of exchange have only two signatures.

The rate of discount varies according to the credit and importance of the customer, and the size of the paper. The big banks also fill their portfolios by buying bills of exchange on the market which have only a very restricted movement, and are not subject to official quotations.

The best paper is that accepted by the great banks and the private banks; these are bought in Paris, in the provinces and abroad. They are presented to the big credit establishments either directly or through brokers.

Before and after the war, the portfolios of the big establishments also included short term French treasury bonds. Money not in use was lent on call, to first class brokerage houses. This traffic was quite new in 1914. The technique was that the lender gave the borrower a draft dated the following day, without guarantee.

Foreign bills of exchange held an important place in the portfolios of the big credit establishments before 1914. Kaufmann makes the following observations on this subject: "They originated partly from the regular operation of internal and external agencies, for the rest the central office buys foreign paper on the market, and also directly from the chief foreign banking houses or from their Paris representatives. London paper, easily negotiable, is the most sought after. The second place is held by the paper of German and American banks during periods, of course, when the rate of exchange and the rate of discount offer a sufficient margin for profit. Nevertheless, these investments, especially those made in American paper, remain within rather narrow limits. In order to eliminate speculation on the rate of exchange, the investment of available funds in foreign bills of exchange, if the difference between the respective rates of discount is sufficient, is made generally at ½–¾% above the market rate of discount in Paris.

The big credit establishments resort to rediscounting, especially on the eve of great loan issues. As we have already indicated, they present only the smallest bills of exchange for the shortest duration. Authors, even those who are most hostile to the great credit establishments, recognize that they have a beneficial effect on the money market and the stability of the rate of discount.

Stock Exchange Loans. The big Parisian banks also practice financing the carrying of securities on the Bourse in Paris, partly to facilitate speculation in those securities in which they are interested. They have also agreed to "contangoes" made on foreign bourses in case there was a considerable difference between foreign and Paris rates. As far as can be ascertained, the great credit establishments and especially the Crédit Lyonnais, lent a considerable amount of capital on the Berlin Bourse.

Other Types of Loans. The guaranteed loans were chiefly advances made on stocks and shares and were very important operations. The advances on current account and without security were less important. In this respect credit establishments were very prudent, sometimes cutting in their credits brutally, for which they were often bitterly reproached. Among the debit accounts current were the advances to foreign banks, granted in

order to find outside of France an advantageous use for available funds. These funds were invested in contango, discounts, loans on securities and also accounts current at sight or at maturity. As a rule guarantees were asked from the banks of the United States for loans made by the French establishments.

Acceptance Credits. The granting of acceptance credits was practiced in France only to a limited extent before the war. At the end of 1909, the acceptances of the three largest banks represented but 50.6% of the paid up capital, and 8.32% of the total investments. Acceptance credits were granted to facilitate foreign commerce. These took the form of financial credits to foreign banks and loans secured or unsecured to large commercial or industrial enterprises. The granting of acceptance credits was practiced in competition with the great Parisian private banks.

Investment Operations. On the other hand, the great French banks of deposit rarely derived any income by means of participation in industrial enterprises: it should be noticed that all the attempts made in this direction were rather discouraging.

The investment operations raised the most violent controversies in France before the war. The great credit establishments were accused of directing savings toward foreign securities to the detriment of French enterprises which could not succeed in finding locally the capital necessary for their development. Opinion is uniform on this point, and the figures give it eloquent support. In the course of the year 1911, according to Professor Germain Martin, 82.6% of the total issues made in France consisted of foreign securities and 17.4% of French securities. French savings endeavored to obtain both foreign state securities and foreign industrial securities. We shall examine the reasons for these preferences and the attitude of the large French credit establishments in regard to them.

Given the tendency of the French people in regard to their savings the big credit establishments were obliged to devote a great part of their activity, before the war, to the investment of funds in transferable securities, especially in foreign government stocks. For the investment in these issues they enjoyed special advantages; a fine network of agencies, a large clientèle consisting of capitalists of varying degrees of importance, whose confidence they had, and a highly centralized organization.

It is impossible to discover from the balance sheets if the banks took part in the issues (emissions) by actual purchase of securities or as commissioners. "On reading over the greater part of the reports," writes Hoffmann, "it would seem that the activity is limited to the operations of an English joint stock bank."

Small issues were rare because of the amount of administrative machinery necessary. Sometimes, however, stock issues of secondary French enterprises, commercial or industrial, were floated in the provinces.

Thanks to the development of their skill in investment, the big credit establishments had become accustomed to offer securities directly to the public, and only subsequently on the Bourse, so as to obtain higher rates and avoid publicity in their operations. They were even successful in placing the stock of companies whose status had not yet been made public, and whose charters, as in the case of Russian corporations, was not definitive. In these cases the banks obtained signatures to application blanks, distributed several weeks before the issue (example taken from Doumergue):

"Director general of the Crédit Lyonnais,

I have heard that you are about to offer at 435 francs, bonds of 500 francs, nominal capital, of a loan of the city of St. Petersburg, of the 5% type, subject to Russian taxes and compelled to subscribe to French fiscal charges. Since these bonds suit me, will you please write me down for ...... shares, the moment the sale begins.

Signed......................."

Each large issue occasioned active maneuvers among customers, who were urged on by canvasses, visits and advice; and they were frequently induced to sell securities which they held in order to subscribe to the new loan; "On the eve of the issues, the Crédit Lyonnais went so far as to urge the customer to sell securities which it had sold to him earlier. As a result, it frequently accumulated considerable quantities of shares which were of previous issues. These securities tended to lower prices and they were absorbed very slowly the second time."

The policy of placing foreign securities through the great French credit establishments has been the object of numerous scathing and well-documented criticisms. The most remarkable work in this field was written by *Lysis* to which the big credit establishments attempted an answer which was triumphantly refuted by *Lysis*. It should be noticed that the arguments of his opponent *Testis* almost always avoided the accusations formulated by *Lysis*.

We shall however, borrow from *Lysis* only a few examples of those deeds for which the great credit establishments are reapproached, and we shall, rather, refer to the moderate and objective criticism of Professor Germain Martin.

French Preference for Foreign Investments. French savings have been directed towards foreign investments only since the end of the 19th century. From 1900 on, these sought foreign employment, especially in Russia, Austria-Hungary, Turkey, the Balkans, and South America. The prudent temperament of the French explains their fondness for state bonds since as investors they are always impervious to the appeals of industry.

" Our ancestors," writes Professor Germain Martin, " were for many years the faithful customers of borrowers who were always unfaithful . . . it is true that the rate of interest promised varied inversely with the regularity of the payment of interest in the years preceding the issues. . . . "

In the course of the 19th century, under the influence of the Saint Simonian doctrines, business and banking enterprises met with a certain success among the big merchants and industrial leaders. The launching of loans for the liberation of the territory, after the Franco-German war of 1870, renewed the taste for investments in state funds whose issue was necessary in order to create the network of railroads (organized into companies but guaranteed by the state,) of telephones, telegraph, etc. . . .

Since 1890, the French state, having educated the masses to the value of sure investments, rarely had recourse to loans.

" This explains the sudden development, after 1895, of frequent public issues of foreign state funds which could be launched in the Paris market with the greatest success. While in 1890, of a total liquid wealth estimated at 94 billions, we had 74 billions of French securities and 20 billions of foreign securities, in 1913, of

a total wealth of from 110 to 116 billions, we have 70 billions of French securities and 40 billions of foreign securities." (Germain Martin.)

The following table, taken from Edmund Théry, shows the probable value of the portfolio of securities of the French people at different periods:

Year	French securities	Foreign securities	Total
	(In millions of francs)		
1850	6,627	2,500	9,127
1869	20,869	10,000	30,869
1880	40,914	15,000	55,914
1890	53,677	20,000	73,677
1892	56,286	21,000	77,286
1899	59,882	27,000	86,882
1908	66,446	38,000	104,446
1913 [6]	70,000	40,000	110,000

To the taste of the French public for foreign loans must be added as a determining factor the policy of the great credit establishments and of the big banks. The profits realized by the banks on these issues persuaded even the provincial banks to take part in the placing of these securities. Certain of these credit establishments committed the serious error of issuing prospectuses setting forth the situation of the borrowing states in much too favorable a light.

" The Paris market became the land of Canaan for those states in search of capital. To be able to place securities on the Paris market meant, for the nation whose securities were admitted to quotation that considerable sums would be granted it at a better rate than could be hoped for elsewhere. Turkey was convinced of this truth when she was refused admission to quotation for the loan, launched in 1910, which was to have been issued at a net rate of 87 francs, when the consortium of German and Austrian-Hungarian banks under the direction of the Deutsche Bank, offered to float it in Germany at a rate of issue of only 81½ net."

[6] Estimates of Messrs. Germain Martin, Buffet and Landry.

The great credit establishments of France were often reproached with this low rate on French capital loaned abroad. They plead the safeness of the investments, notably in Russia, Bulgaria and Turkey. Events demonstrated the emptiness of these assurances. Signs had not been wanting, however, both as to the policy of the Balkan states and as to the future of Russia, already undermined by the revolution of 1905. Lysis wrote in 1910: " Our big banks have introduced 16 billions worth of Russian securities into France. Whatever may be the ultimate outcome of these investments, no one can deny that they have been made under the most risky conditions. . . . For 22 years in succession, Russia has had a deficit. . . . In the space of 15 years, Russia has borrowed 15 billions abroad. Of this enormous sum, she has spent only 3 milliards on productive enterprises, while she has used the rest for military and naval expenditures, famine relief, etc. . . . It should be noted also that in order to pay her foreign coupons, Russia must export each year a quantity of gold estimated at 700 millions, that she cannot obtain this precious metal except by selling her wheat, and, consequently, if there is a bad harvest several years in succession, she can no longer pay her debt. It should be noted furthermore, that the Russian government is in the throes of revolution. . . . Our big banks have committed the crime of fabricating a false credit for Russia. When we began to loan money to Russia, she was practically bankrupt, the English and German markets were closed to her; she could borrow nowhere. Her credit was consequently wretched. Under such conditions — they still existed in 1896 — our establishments had the audacity to issue 3% Russians loans at 92.30, that is they decreed that Russian credit was worth 3¼% and that it was equal to and even higher than that of rich industrial Germany.

" As long as we furnish money to the Tsar, he will pay our coupons. This formula is general, and is not applied to Russia alone . . . in order to maintain the credit of her debtors, France is continually obliged to grant them new loans."

According to several authors, the French government was responsible in directing the investment of savings: it obliged the credit concerns to yield to Russian demands. " Each time that the sentiments of political alliance weakened, it was well known

in the highest circles, that this coldness would be followed by a proposal for a new loan. French savings were the stimulating fuel of a necessary alliance." In June 1918, on the occasion of a discussion of banking reform, the minister of finance declared; " But I say to-day that the state has assumed in the past a much more real responsibility than the banks. I maintain that it is the State, and consequently the government which carries the responsibility under the circumstances."

The late president of the Crédit Lyonnais maintained, in 1903, the thesis that the credit establishments are a group of individuals who have put their capital in a common fund, and who have delegated certain of their number to handle it. The administrators have the right and the duty to loan these funds abroad rather than to national industries, if they find it more profitable to do so. But this argument was specious since foreign securities did not remain in the portfolio of the bank but passed to the customers. It was the public which paid the cost of these investments, which were the object of great commissions for the banks.

Professor Germain Martin has clearly shown, in the case of Russia, that the foreign commerce of France was not responsible for the existing financial relations.

Year	Exports from France to Russia (In millions of francs)	Imports from Russia to France (In millions of francs)
1911	53	443
1912	62	432
1913	85	461

The states which borrowed the most from France: Russia and Turkey, bought the most from Germany.

The French liking for foreign securities in general arose also from certain internal political conflicts so that foreign industries obtained capital which French industries needed.

Issue of industrial securities in France (in millions of francs).

	1910	1911	1912
French industrial securities	779	807	1,648
Foreign industrial securities	3,908	2,893	2,657

The president of the Crédit Lyonnais whose opinion we have already referred to, openly discouraged the endeavors of French industrials. In 1903, before the general assembly of stockholders he made a statement justifying his lack of interest in French business affairs by citing the mediocrity of the French manufacturers. This statement raised a great clamor in France, and has since been frequently quoted: "We shall not enter this path for several reasons. First because a business, in order to be successful, must be directed by capable men, and we do not pretend to have about us thousands of men capable of directing a business. . . . Not having these several hundred thousands capable men at our disposal, we hesitate to take part in the very best businesses, because one is so often mistaken.

"Perfect direction is necessary to conduct a business successfully; and capable directors are very rare: a tenth, and that is already an exaggerated proportion."

It can readily be understood that such theories, even if they were only whims, discouraged French initiative.

Criticisms of Investment Policies of Great Credit Establishments. The great credit establishments were reproached also with having loaned 125 million francs to Brazil to finance the coffee producers of the state of Sao-Paulo, while those of the French colonies could not obtain capital. They were also reproached with their refusal to participate in the committee for the study of cotton culture in the French colonies, with having facilitated the issue of an Argentine loan in France in 1909, while orders for cannon to the amount of 150 million francs were given to Germany by Argentina. The case of a French industrialist was also cited, to whom the banks of his country refused the capital necessary for the building of a factory, and who obtained the capital in Germany. Similarly the case of a sugar central in Porto-Rico which, because of lack of capital passed from French to American control. When the plant was in foreign hands, the big French banks gave it a credit for 10 years' duration, whereas a credit for one year had been refused to the French directors.

The great credit establishments were also reproached with having subscribed to the issues of German enterprises and with having loaned capital on contango to the German banks, which in

this way could promote the German economy. For one who knows how antagonistic the two nations were to each other before 1914 and how they each lived in the certainty of an approaching war, this criticism was the most serious which the French could have made of their banks.[7]

French savings suffered heavy losses in investments in foreign industrial securities. To quote one author:

"Now, all the French colonies taken together, including Morocco, had absorbed only a total of 4 thousand millions (milliards).

"If, after 4 years of war, an investigation should be made as to which investments among those made outside of France had best resisted cataclysm, it would be found that the sums entrusted to our colonial enterprises showed a continued stability of which the stockholders in Balkan, Russian, Turkish, Austrian, German and South-American funds were completely ignorant.

"The financial help of our foreign portfolio would have been effective beyond measure if our thousand millions (milliards) had been loaned to colonial enterprises and had helped to promote the riches of especially North Africa.

"French savings were disappointed, to be sure, in their search for sure investments. The great hopes based on the facilities which our available funds invested abroad should have given us, were brought face to face in reality with very pitiful results."

Branches of Great Credit Banks. The operations of the great credit establishments made themselves felt, as we have already said, because of a very wide spread network of branch offices, in France and abroad. It was estimated, before the war, that approximately 1,000 banks and credit concerns in France had 6,000 offices, that is one office for every 6,700 inhabitants or one for every 300 merchants or manufacturers. The five large banks studied by Théry had 2,000 branches, agencies or offices, that is ⅓ of the total mentioned above.

The great credit establishments preferred the direct establishment of branches to amalgamation which was customary in England and in Germany and which consists in absorbing an existing

[7] At the time of the Agadir incident, the withdrawal of funds, temporarily placed in Germany by the French banks, caused considerable difficulty to the industries on the other side of the Rhine. (Germain Martin.)

enterprise. Some banks of secondary importance did employ amalgamation as a means of concentration, so as to enable the parent house to benefit from a secured position. The internal organization of the agencies of the big credit establishments rested on the extreme subordination of the manager to the central administration. They did not have a fixed fund at their disposal and the use of capital from the head office gave to the agency an extremely low return on its deposits. This led the agency to offer its liquid capital at a particularly low rate, always higher however than the infinitesimal interest paid by the central office on its deposits. It therefore happened, at certain times, that they offered loans at a lower rate than the parent bank. Inversely, in the textile regions, for instance, when the season for country (de campagne) credits approached, the agencies offered a higher rate on deposits so as to procure liquid capital on the spot for which the parent house demanded a heavy rate.

Before the war, the big credit establishments had agencies in the following countries:

England: London, Liverpool, Manchester;
Spain: Barcelona, Madrid, Seville, Valencia, San-Sébastian;
Russia: Petrograd, Moscow, Odessa;
Turkey and the Levant: Constantinople, Smyrna, Jaffa, Jerusalem;
Egypt: Alexandria, Cairo, Port Said;
Belgium: Brussels;
Switzerland: Geneva;
Monaco: Monte Carlo;
Australia: Sydney, Melbourne;
India: Bombay;
Tunis: Tunis, Bizerte, Sfax, Sousse;
Madagascar: Jagence.

The Comptoir d'Escompte had the most marked expansion. The agencies had a double purpose: to facilitate commerce overseas, and to find investments at a more remunerative rate on the liquid assets which it was difficult to place in France where they had originated. The overseas agencies were useful for discount-

ing and for the collection of the documentary bills representing the exchange value of merchandise imported into France; they also enabled European commercial houses to draw on them for cash, on the guarantee of shipments of industrial or manufactured products.

The agencies abroad did not try to attract deposits on which they would have to pay a higher rate than that paid in France by the parent house. Considering their first-class standing, they received a considerable volume of deposits. The utilization of these deposits in countries with a depreciated currency was not without its dangers.

The operations of agencies abroad were adapted to local customs. " But," writes Kaufmann, " with a few exceptions, the commercial principles of the parent house had penetrated the policy of their foreign agencies. This resulted in a certain inferiority for the latter in their competition with the foreign banks of the same locality, especially with the German and English institutions. Being far more ready to extend credit, the latter made themselves masters of the market. Nevertheless, the French banks had a certain advantage: they could grant loans at a lower rate than their rivals, because of the cheapness of deposits in France."

These advances at higher rates enabled them to give a more lucrative employment to deposits, which were continually increasing in the metropolis, by making use of the difference between the rates in the money markets of the two countries.

There were also, in the international financial markets (London, Brussels, Petrograd, Madrid,) agencies created to promote stock exchange operations, financial deals and to facilitate the investment of foreign securities in France, and the investment abroad of the remainder of loans which had not been placed in France.

In London, the French agencies carried out, on the spot, the monetary and credit operations of the registered office. They made a profit from the difference between the rates of interest in London and in Paris and also from arbitraging in bills of exchange.

The agencies in the colonies and in the new countries helped to finance the export of raw products from these territories. In

Spain, the situation of the agencies of the great French credit establishments was prosperous, in spite of the difficulty of using deposits on which no interest was paid, and which were used as loans to equal the difference between the cash and settlement prices on the Bourse. The Russian agencies benefited from the constant high rate of interest in Russia and from a considerable afflux of local deposits. Kaufmann advanced the opinion that the French agencies in Russia showed themselves to be " particularly liberal when it was a matter of granting credits to commerce and agriculture, in order to gain the sympathy of public opinion and of the government." The agencies of the Levant benefited from the propaganda and political influence of the French Republic and from the distrust which the population felt for Great Britain. They facilitated the importation of raw silk from the near East to Lyons.

The Brussels agencies sought investments for French capital, and served as a stage in the lending of these liquid assets on contango in Germany.

The great French credit establishments had, moreover, frequent relations with foreign banks, notably the German banks.

Because of the placing of the loans of foreign countries, because of their agencies and subsidiaries, which we will study later, the great credit establishments played an important rôle. But the active rôle abroad, in the international syndicates (consortiums) was played by the " big private banks " and the " business banks " which transacted business on behalf of the big establishments.

Canvassers. Before summing up our rapid review of the great French credit establishments we must speak of a certain group of intermediaries whose exclusive rôle is to bring business to the banks: the canvassers (demarcheurs). These bring in discount customers, place titles, collect stock exchange orders, and attract deposits; they are given great liberty, the directors reserving the right to disavow them in case too great pressure is brought to bear against their customers.

" The canvassers visit a great number of manufacturers and merchants, the medium, the small and the very small capitalists of the town and also of the neighborhood. In this way, it often happens that the same small place, situated between two or

three agencies of one bank, is covered successively in the same day by canvassers from the various agencies of the same bank. The canvassers are a very important part of the organization of the big banks. It is certain that without their help the eviction of the local banks by the big banks could not have been accomplished in many cases with such great speed." (Kaufmann.)

Diversification of Risks of Great Credit Banks. The big centralized bank with a network of agencies, has for this reason, a more profitable use for its capital and its deposits than the local bank. The former hardly suffers from the withdrawal of its deposits in the case of a local monetary tightening. It can combine the branches situated in regions which have always a surplus of capital with those which suffer from a constant shortage; in the same way, it can use its capital for campaigns which take place at different times. The existence of agencies abroad enables it to invest there whatever capital may be available.

It is known, from the example of the small local banks of the United States, how closely these small credit concerns are bound to the industry of their particular region. The large centralized bank can, on the other hand, divide its risk in a fairly regular manner: a crisis in a particular industrial domain will affect it less than a local bank: a local crisis is generally favorable to it, because it either takes advantage of it to establish itself in the region, or to stifle local competitors. That is why the great French credit establishment has so often created an entirely new agency when it could have taken over the local bank whose place this new agency fills.

"Agencies are rarely established without careful forethought. The big banks usually choose a propitious moment: a local crisis, bankruptcy, the failure, the cessation of payment of a local bank, the death of a banker. Thus, the agency at Calais of the Crédit Lyonnais," Kaufmann points out, "was established at the time of a regional crisis, those of Mazamet, of Tourcoing and of Roubaix at a time when these places were suffering from the Australian crisis of 1893. At Mans, it was following the failure of a local bank. In a few places, the establishment of an agency was promoted by a wish expressed by the local merchants."

Discounting at reduced rates was the offensive weapon of the big banks. The canvassers worked over the territory to recruit

discount customers who later became customers for the investment of securities.

The Deposit Banks and the Bank of France. The big French deposit banks became dangerous rivals of the Bank of France, whose discount portfolio fell relative to that of the big private establishments which are not subject to the rules governing the central bank. The average duration of the bills discounted by the Bank of France has decreased also, as well as their average size; the big deposit banks, as we have already stated when studying the discount policy of the Bank of France, send only their shortest term notes to be rediscounted. In spite of all this, the big deposit banks continue to rediscount a considerable amount regularly at the Bank of France, in order to have sufficient liquid reserves on hand.

The Deposit Banks and the Money Market. Kaufmann believes that banking centralization has inaugurated a prudent monetary policy which lessens and tends to eliminate crises. This stability has increased the importance of Paris as an international financial market.

The big credit concerns have developed the field for the placing of transferable securities but have weakened the official market by placing securities directly. If, in France, the centralization of the four or five big banks has lowered the rate of discount, if it has facilitated business abroad and has contributed to the stability of the official rate of discount, on the other hand, before the war, it stifled initiative. One must take into account obviously the liking of the people for investments giving a definite return. "But," says Kaufmann, with considerable objectivity, "it is a gross exaggeration, if not contrary to the truth, to attribute the exodus of national savings to foreign countries to the centralization of the banks, and to claim that French capital 'torn' from national industry, is employed directly or indirectly for the benefit of its foreign competitors. In the first place, it is inexact to state that savings always found employment in national industry as long as the representatives of the big private banks and of the local banks were in power: a great part of the national savings were formerly simply hoarded."

From the point of view of the stockholders, the great credit establishments have shown brilliant results. From the national

point of view, they have contributed greatly to the stability of credit conditions but have tended to direct savings towards investments which have proved to be bad.

The Deposit Banks and the War. The declaration of war placed the big credit concerns in a different situation and changed entirely the orientation of their policy. The French government proclaimed a moratorium of deposits and of bills of exchange. The great credit establishments were obliged to have recourse to rediscounting on a huge scale at the Bank of France; but even that did not enable them to pay up the total of their deposits before December 31, 1914, and they have been reproached with not having enough liquid assets. On December 18, 1914, Minister Ribot expressed himself as follows on the subject of the big banks: " The great credit establishments would not have needed these measures of protection if they had confined themselves to utilizing the greater part of their deposits for discounting bills of exchange, negotiable at the Bank of France, and if they had only used their capital and their reserves, as prudence should have dictated, for advances on securities or for operations which could not be liquidated in a crisis on short maturities, they would not need these protective measures. André Théry, whose sympathy for the great credit establishments is evident, admits that there were imprudent immobilizations in securities, due chiefly to lack of foresight on the part of the directors.

" During the war, the productive capacity of France was reduced because of the calling of the reserves to the army and because of the invasion of her territory; all efforts were concentrated in behalf of national defense and the economic rôle of the State was considerably enlarged. In order to meet its many obligations, the government had recourse to grants of credit, and, by becoming the largest borrower, produced a new set of economic conditions, inflation among the rest. These conditions exercised an influence on the life of the big centralized banks. The liquid capital of the banks for deposit remained low, deposits increased very slightly: Théry saw in this a sign of prudence; to this must be added the rival demands of the National Defense bonds, and the necessity of increasing the working capital of industrial enterprises. Discounting scarcely developed, because of the effect of the moratorium granted to bills of ex-

change on public opinion which brought about the habit of concluding transactions in cash.

" The criticism of the policy of the big credit concerns before the war in regard to the placing of securities must be called to mind, in which the war brought about radical changes. Savings stayed in the country, primarily because relations with foreign countries had been destroyed, because it was forbidden to export gold, because France could only balance her accounts by means of credits and loans and finally because when the State resorted to credit, it absorbed all available capital. Furthermore, the State endeavored to turn the movement of capital to its profit."

Control of Investment Operations during the War. A law of May 31, 1916, forbade until a date fixed by decree, after the cessation of hostilities, " the issue, the exhibition, the putting up for sale, the introduction on the French market of rente certificates, loans and other public securities of foreign governments, of bonds of whatever nature, of towns, corporations or societies, whether French or foreign." Concessions in favor of French industries were granted during the war. Later prohibitions relative to movements of capital with foreign countries were enacted, with the corollary that no securities of whatever kind should be brought into France.

After 1916, a decree of the minister of finance invited the holders of neutral or American securities " to give them up provisionally for the benefit of the State so as to give it supplementary means of exchange." In the first instance the arrangement was that of renewable loans for a period of one year; as a matter of fact, the French government bought securities which were loaned to it, to the amount of one and one-half thousand million francs, of a total of about fifteen thousand million of Spanish, British and North American securities.

The result was that the great credit establishments were no longer able to devote themselves to one of their most important and lucrative operations. They occupied themselves with State issues, with the financing of national industry and very little with foreign funds. The two tables on page 593 show the evolution which took place during the war:

Issues and introduction of securities from 1900 to 1913.			
Year	French securities	Foreign securities	Total
	(In millions of francs)		
1900	1,268	1,340	2,608
1901	641	2,051	2,692
1902	287	1,429	1,716
1903	777	2,356	3,133
1904	440	2,885	3,325
1905	885	3,000	3,885
1906	870	4,206	5,076
1907	968	1,878	2,846
1908	731	2,749	3,480
1909	1,786	2,508	4,294
1910	885	4,726	5,611
1911	814	3,881	4,695
1912	1,959	3,081	5,040
1913	2,169	2,757	4,926

Issues and introduction of securities on the French markets during the war.

	French securities	Foreign securities	Total
1915	(In millions of francs)		
Bonds of the state, cities and departments	15,204	—	15,204
Sundry Obligations	329	—	329
Issues of Stock	36	2	38
	15,569	2	15,571
1916			
Bonds of the state, cities and departments	11,513	—	11,513
Sundry Obligations	413	8	421
Issues of Stock	145	99	244
	12,071	107	12,178
1917			
Bonds of the state, cities and departments	15,435	—	15,435
Sundry Obligations	1,587	—	1,587
Issues of Stock	475	151	626
	17,497	151	17,648
1918			
Bonds of the state, cities and departments	30,690	—	30,690
Sundry Obligations	1,127	—	1,127
Issues of Stock	629	72	701
	32,446	72	32,518

The big French government loans have evidently played a dominating rôle; since the market for capital in France has not been influence by issues of bonds of foreign States. The issue of bonds was more frequently resorted to by private enterprises than was the issue of stock. War industries, on the other hand, were fortunate to be able to borrow for a fairly short length of time, by having recourse to the credit of the banks. This is what has brought about an evolution in the commercial methods of the great credit establishments which, according to Théry, have developed personal credit to a certain extent. During the war, exports of capital suffered an almost total eclipse, while imports developed strongly.

Attempt to Encourage Use of Checks. In France, as in all the belligerent countries, the public authorities and the central bank developed an intensive propaganda to make the public familiar with methods of bank transfer and clearings. The report of the Bank of France for 1918 says as follows: "A greater part of the available capital could be temporarily invested in bonds or obligations for the national defense; the Treasury could dispense with having recourse to advances from the Bank for covering State expenditures, up to the limit of this supplementary fund; unproductive savings would then take part in the enormous movement of capital necessitated by the war, the activity of the fiduciary circulation would be increased, and consequently its volume could be reduced." The legislature passed laws favorable to the spread of the use of checks, especially of the crossed check. The big deposit banks seconded the movement.

Effect of War on Branches. Expansion by means of the agencies of the deposit banks suffered a serious check during the war: the invasion of part of France caused 21 agencies of the Crédit Lyonnais to pass out of the control of the parent house; and 135 offices of this important institution were closed because of personnel called to the armies. All of the big banks suffered the same fate. However, the Banque Nationale de Crédit succeeded, on the other hand, in extending its network of agencies by the system of amalgamation and by purchasing the shares of secondary banks, transformed into branches.

Post-War Expansion of Branches. Immediately after the cessation of hostilities, the great credit establishments pro-

ceeded to increase their capital and took up again their policy of extension by means of agencies. The closed branches were reopened, and new ones were established in the liberated regions (Alsace-Lorraine), abroad, and in the colonies. The density of the network of national branches was increased. In 1919, the Société Générale opened offices in Constantinople, Bona, Mostaganem, Barcelona; the Banque Nationale de Crédit opened 30 branches and 30 offices in one year. All the big banks do not give information as to the expansion of their agencies in their annual reports; those which do, present it with a certain irregularity. In any case, the following indications will make sufficiently clear the tendency not only of the big credit establishments, but also of the local and regional banks, to extend their field of action so as to drain deposits from the small towns and the country districts. This action reveals one phase of the competition between the big centralized banks and the local and regional banks for which, as we shall see, the war was the cause of a veritable renaissance due chiefly to the necessity of financing the industrialization of certain regions.

In 1922, the Comptoir d'Escompte created six agencies and subagencies and 54 part-time offices. The Crédit Lyonnais opened 8 and 54 respectively; the Banque Nationale de Crédit increased the number of its houses from 437 to 442. For the big French regional banks the movement was similar; the Crédit du Nord opened 22 agencies in 1922. From 1914 to 1922 the number of houses of the Société Nancéienne increased from 36 to 148.

In 1923 the movement was accelerated: thus the Crédit Lyonnais established 100 new offices and agencies and 51 part-time offices in 1923. The Comptoir d'Escompte opened 10 subagencies and 42 part time agencies. We have but approximate information for the part-time offices of the Banque Nationale de Crédit; we know it opened 8 agencies. The Banque Privée established 12 agencies; the Crédit du Nord, 34; the Société Marseillaise, 5; the Société Nancéienne, 18. In Algeria, the Compagnie Algérienne opened 12 new agencies and several foreign offices.

" It is an established fact that there is an accentuation of the tendency for the regional banks to spread out more and more

towards regions which are far from their original sphere of action."

In 1924, the banks continued to carry out their program of extension, viz.:

	Agencies and subagencies	Part time offices
Crédit Lyonnais	39	62
Comptoir d'Escompte	5	42
Banque Nationale de Crédit	7	23
Banque Privée	5	—
Société Marseillaise	3	—
Société Nancéienne de Crédit	2	—

For the years 1925 and 1926, precise information is lacking. But it is evident from the reading of the reports that the banks have continued their movement of expansion through agencies, with a double aim: first, to drain deposits, especially in the parts of the country where, as a result of monetary fluctuations, it was necessary to fight against the propensity of the peasants to hoard bank notes; in this way, the banks were able to profit from the beneficent results of agriculture and vine-culture; secondly, by extending their network of branches, they divided their activities between different regions and different industries and, in this way, stabilized the credit situation.

A Summary of the Effects of the War on the Credit Banks. The economic reorganization of France brought with it certain consequences for the banks in general and for the great credit establishments in particular. By 1920, 77% of the devastated industrial establishments had been reopened; the interventionism of the State relaxed in part, though its need of credit had not ceased to increase. The depreciation of the currency had been translated into falling rates of exchange and rising prices, which increased credit needs. The commercial portfolios of the great credit establishments have grown considerably, but since these include National Defense bonds, any scientific conclusion is impossible. Issues of foreign securities have picked up since 1919, but they are of small importance in proportion to the issues of French securities; in 1920, French bonds and shares amounted to 13 thousand millions; foreign bonds and shares to 124 millions, which is insignificant when one thinks of the proportion before the war. On the other hand, the issues of French

securities, not including State funds, have become very large, and testify to the reawakening of French industry as well as to the depreciation of the currency.

The deposits of the great credit establishments have not increased in proportion to the depreciation of the currency. The following table, prepared according to a graph in the *Revue d'Economie politique,* for the four great credit establishments, illustrates clearly this tardiness of deposits to adapt themselves to the depreciation of the currency, a tardiness which is found to exist in almost all countries.

Base: 100 in 1913.

	1919	1920	1921	1922	1923	1924	1925	1926
Notes	650	655	650	650	655	725	900	900
Deposits	225	250	250	255	275	270	375	410
Dollar exchange rate	225	325	250	300	400	350	525	500
Increase of the pledges on demand of the Bank of France	505	517	489	482	502	531	679	734

LOCAL AND REGIONAL BANKS

Alongside of the large credit establishments which we considered in the previous chapter and the " crédit mobilier " banks or business banks (banques d'affaires) which we shall consider subsequently, there is a number of local banks for deposit and credit situated in Paris and in the provinces. According to Kaufmann, only 13 of them, in 1913, had a capital of 10 million or more among the entire number. There were several hundred whose exact returns were almost impossible to obtain.

In the minds of the authors interested in the question of these local banks, they existed because the large credit establishments could not specialize in business credits and the local banks assumed this task. Professor Germain Martin thought them well fitted for this purpose. " First, because of the amount of their personal capital. It was estimated that in 1913 six hundred local banks, having 1,000 counters, had a total capital of about 1,700 millions. The paid-up capital and the reserves of the four great credit establishments amounted to only 1,079 million francs on December 31, 1913."

But the mission of the local banks could not be fulfilled except with great difficulty and, in many cases, they were obliged to retire before the great credit establishments which, starting from Paris, branched out over the entire country and had the benefits of superior equipment, of wide distribution of risk and ability to extend credit more cheaply due to the possession of large deposits.

A considerable number of banks, however, were able to withstand the great credit establishments. The reasons for this are not without interest. One cause lies in the methods of expansion employed by the big Paris banks. "It is, indeed," writes Albin Huart, "that instead of carrying out a policy of amalgamating the principal local banks covering a given district, and converting them into branches, our big banks have endeavored to enlarge their field alongside of the local banks, showing a great activity. This method of expansion is open to criticism, for it can be shown that amalgamation would have resulted in a considerable saving for the big bank after it had taken over the local banks, in an estimate based on its latest balance sheet and furthermore such a policy would have brought to it a tried clientèle as well as the experience of well-known and trusted directors.

"While it is demonstrable that the policy adopted by these credit establishments has not been disastrous for them, since they have covered the country with a network of branches . . . nevertheless they have done so at great expense, from the necessity of keeping up a veritable army of canvassers, who by seeking out small savings on all sides, have obtained from the savers considerable deposits and have succeeded in forcing them to accept foreign investments. The work of establishing this clientèle had taken thirty years, which could have been considerably shortened if the local banks had been absorbed, pure and simple."

Only a few cases can be cited where local banks had been absorbed before the war: the Comptoir d'Escompte absorbed eight local banks, the Crédit Lyonnais, only one. On the other hand, many provincial houses have fallen victims in the bitter struggle, in consequence usually of extending an undue amount of credit to doubtful debtors, in a vain effort to preserve a clientèle.

It is undeniable that the extended network of the agencies of the great credit establishments has greatly injured the local banks: "Instead of replenishing their treasury, for the needs of

the commercial transactions which they have in hand, by recourse to rediscount of their portfolio at the bank of issue," writes M. Georges Charpenay, censor of the Bank of France, " the large credit establishments prefer to seek deposits in specie by paying interest, which, though low, suffices to attract a clientèle composed of those who wish to be able to withdraw their funds at any moment. The difference between this expense and the discount charges left the credit establishments a considerable margin of profit. The local bank, on the other hand, had to be satisfied with smaller profits, for between the rate of discount which is charged and that at which it had to negotiate its own paper at the bank of issue there was but a small margin of profit, and this was reduced still further by the keen competition which resulted in the loss of many clients attracted by the advantages of the great rival houses. Furthermore, the local bank found itself in a very hazardous situation. It had to give up specializing in the discounting of commercial paper with short due dates and to be satisfied with the financing of new enterprises either by accepting issues of stock, by assuring the placement of loans or simply by the opening of relatively long term credits.

It must also be realized that the credit establishments and the local banks had two different objects in view.

The first tended to undertake transactions of vast scope, the second were satisfied to develop local industries.

This development necessitated credit operations of medium to long terms, which the big establishments did not willingly undertake; such operations require considerable individual capital, and a thorough knowledge of the clientèle which justifies the advancing of funds partly on account of the high character of the borrower; a thing which the director of an agency, a technician merely, could not consider. The local banks, lending their capital to those firms, to which they would furnish credits for several months or for several years, naturally followed the business very closely. They gave long term loans, placed the bonds of companies, especially debentures. This situation was very favorable for industry, but was not without danger for the local bank during prolonged local crises.

" This support given by the local banks to their clients," writes Professor Germain Martin, " has won them, once the danger is

passed, the devotion of a group which is held together by obligations and business bonds which are not lightly broken. This explains how the local banks can continue in spite of the competition of the credit societies."

In order to hold their own against the competition of the big credit establishments, local banks have developed in other respects. They have been obliged to extend their field of action; in other words, they have imitated on a small scale their rivals; from *local* they have become *regional,* they have created a network of agencies, and frequently a house in Paris.

It should be noticed that contrary to the policy of the great credit establishments, the local banks have often made use of amalgamations: the Bank of Bordeaux, with a capital of 16 millions, has absorbed eight local banks.

Central Society of Provincial Banks. Furthermore, the local banks have created a central organ of mutual protection at Paris, the *Syndicate of provincial banks* which in turn has established the *Central Society of provincial banks.*

The chief function of the provincial bank, as we have seen, is to extend relatively long-term credits, often in the form of advances on current account. The capital of these banks, relatively high in proportion to their obligations, enables them to carry on these operations on current account to which the great credit establishments are averse in their anxiety to maintain liquidity.

The second function of the local banks consists in the assistance they can give to the flotation of national and especially of regional securities. The provincial bank is plainly the one which should undertake the issue of the securities of the companies which it patronizes. Before the war great difficulties lay in the way of the accomplishment of this task because of the competition of high interest bearing paper thrown on the market by the great credit establishments. The provincial banks were also greatly tempted to invest in or offer for investment foreign paper responding thus to an almost basic need of the French investor. Nor did they wholly escape.

In 1904–05, the Central Society of Provincial Banks, was established with four hundred members. Its aim was, primarily, to occupy itself with industrial and financial affairs. Until 1911, in accordance with the views of its founders, it was occupied with

the establishment of various industries, small and large. Realizing, however, that its profits were not comparable to those of the great credit establishments the society changed, and became more like its rivals. Albin Huart reproaches both the society and the provincial banks with the fact: " These banks," he says, " favor foreign loans more and more, as if their attraction were so strong that these very banks which were founded to counteract the tendency of capital to emigrate, themselves succumbed to the attraction." In fact the concentration of provincial banks should have enabled them to take a larger part in preventing loss in the amount of state wealth. " Nevertheless," continues Albin Huart, " such cases have been very rare, and we, who have always supported the local banks to the best of our ability, may surely be allowed to express a criticism of this policy which we believe to be only too true: The Central Society has too often taken an important part in syndicates for the issue of foreign securities? "

The attempt of local bankers, made before the war, to resist concentration and to favor investments of regional assets, has therefore not produced the desired results. In certain regions, nevertheless, powerful local banks have survived, chiefly in the north and the east. But we are considering, rather, regional groups. In Savoy and in Dauphiné, the capital invested in the electrical industry from 1898 to 1914, amounted to 400 million gold francs, most of which was raised by the local banks.

The *regional* concentration of the French banks is undeniable, and alongside of the four credit establishments the banks of Nancy, Lille and Marseille have branched widely in their regions. We shall see presently that their expansion since the war has not been negligible.

The Lorraine Group. An interesting type of before-the-war local banks is that of the Lorraine group: Société Nancéienne de Banque et de Dépôts, Banque Renauld, Comptoir d'Escompte de Nancy, Banque de Nancy. They operate in the mining region of the Meuse, the Meurthe and Moselle, the Vosges and especially in the Briey basin. This region, influenced by the financial market of Nancy, could put at its disposal, it was estimated, capital up to 1,789 millions. The local banks of the region ruled industry; they organized companies whose securities they placed among their clients, chiefly by the method of " instalment selling."

Société Marseillaise. Also worthy of mention is the activity of the *Société Marseillaise de Crédit industriel et commercial et de dépôt* which Kaufmann and Huart agreed should be considered separately: it was established at Marseille in 1865, but as early as 1880, created an agency in Paris. The head house in Marseille was a bank chiefly of deposit and credit; the Paris agency, which was very important, was chiefly a financial bank and developed rapidly after 1900.

The business of making advances on merchandise (Egyptian cotton) was of great importance to the house at Marseille, and it had a large portfolio of foreign bills of exchange.

The bank took part in Turkish and Greek financial affairs, thanks to a community of interest with two Greek banks. It also undertook independent issues of securities although belonging to the consortium of the big credit establishments. It had established single-handed several large industrial enterprises, and transformed private enterprises into limited liability companies.

The Alsatian Banks. We should not prolong this monograph on the regional banks of France. However, before studying their development since 1914, we believe that we should call attention to the fact that the Alsatian banks, established before 1870, which became German after the conquest of Alsace-Lorraine by the Empire, had kept their French organization right up the year 1914, belonged to the French syndicate of provincial banks, and pursued the placement of French securities. Furthermore, they had kept their old relation with the cotton and wool industries of the East of France and had extended these relations by developing their network of agencies. The *Bank für Elsass-Lothringen* of Strasburg, had thirteen agencies, of which eight were in France, the *Banque de Mulhouse* had seven of which five were in France. The *Comptoir d'Escompte de Mulhouse* with a capital of 15 millions (established in 1848) had forty agencies of which thirty-nine were in France and of these, one was at Lyon, one at Marseille, one at Havre, to facilitate the operation of its clientèle of cotton exporters. The Comptoir and Banque de Mulhouse had also a foothold in Paris. In 1913, a French company with a capital of 100 million francs, a branch of the Comptoir de Mulhouse, took over the network of agencies belonging to the latter. This branch, *Banque Nationale de Crédit*

had created or acquired, in the course of its first financial year, twenty-three offices or agencies.

War and Post-War Development of Regional Banks. During the war, a certain number of local banks developed considerably, due to the partial elimination of the competition of the great credit establishments. The banks of Dauphiné and Savoy contributed largely to the use of hydro-electric power in these regions. The increase of capital brought about during the war was often due to banking enterprises of moderate scope. "During the war there was, it seems," wrote A. Théry, "a characteristic change in the movement of concentration; the temporary interruption of the policy of extension on the part of the principal credit societies, on the one hand, on the other hand the development of the power to increase the field of action of certain secondary organizations, some of which even became competitors of the largest credit establishments."

In 1923, M. Jean Loriot, in the *Revue d'Economie Politique,* thought that certain regional banks such as the Société Marseillaise, the Société Nancéienne, the Banque Renauld, the Crédit du Nord, on account of their rapid growth deserved a place, in a study of banking conditions, alongside of the big credit establishments with which they were competing.

In 1923, great numbers of the regional banks, made very large increases in their capital so that the latter might be in proportion to the increase in deposits. Thus, while the deposits of 1922–23 compared with those of 1913, increased from 223% to 300% for the four big credit establishments of Paris, the increase was much greater in the case of certain regional banks:

Crédit du Nord	877%
Société Nancéienne	673%
Banque Privée	622%
Société Marseillaise	554%

At the same time, the policy of creating agencies was systematically followed by the regional banks, in competition with the great credit establishments. Thus, the Banque Crédit du Nord established 34 agencies in one year.

The provincial banks, deprived as were the big credit establishments, of the profits of foreign issues, which the Central Society of provincial banks no longer procured for them, the law

forbidding the exportation of capital being in full force, developed vigorously their banking operations.

It is difficult to judge, at the present moment, an evolution which is only outlined, but it seems that the local banks, having become regional, and having cemented their relation with provincial industrial enterprises during the war, have consolidated their situation so that they have ahead of them great possibilities for further development.

INVESTMENT BANKS (BANQUES D'AFFAIRES)

Banks which make use in general of their own resources, or those of groups of capitalists are called " banques d'affaires," " banques de crédit mobilier " or " sociétés financières." The chief aim of these institutions is to launch commercial or industrial enterprises.

Deposits are of secondary importance, and frequently they will accept them only from foreign banks, from limited liability companies which they have established, and with which they keep in contact. If, for example, they have placed stock for one of the companies which they patronize, a part of the loan realized is deposited with them. Often also they serve as banks for the societies which they have founded.

" These are usually," remarks Kaufmann, " the big banks. The lesser houses cannot undertake these operations except occasionally, because of the large amount of capital necessary."

These " banques d'affaires " have partially replaced the private banks, " the haute banque " which we shall consider subsequently.

Industrial finance is the aim of all of them, to place among their customers the stocks or bonds of big enterprises. Business of this type being irregular and depending on various circumstances, some of the " banques d'affaires " gave a secondary place to credit operations; they opened current accounts for industrial enterprises, current accounts which were sometimes settled with an increase of the capital or an issue of the bonds of the debtor companies. They still carried out stock exchange orders. " But," says Huart, " that is but a side issue to their fundamental

operations which consist in the handling of the shares which they place."

The profits of these "banques d'affaires" are necessarily irregular and affected by financial crises, the latter preventing the issue of stocks and shares. They supplement the irregularity of their profits by gathering together large reserves in prosperous years, so as to keep their dividends at the same level. These banks are necessarily few in number. Among the most important are: the Banque de Paris et des Pays-Bas, the Banque de l'Union Parisienne, the Banque Française pour le Commerce et l'Industrie, the Crédit Mobilier français.

The Banque de Paris et des Pays-Bas, is the most important. It places issues on the Paris market, and also in Belgium where it has a very important branch. It finances industrial enterprises in France and abroad and, before the war, floated numerous loans of foreign states and cities. "The real clientèle of the Banque de Paris et des Pays-Bas is composed of French or foreign banking houses, and important friendly capitalists; it does not have direct relations with the general public.

The Banque de l'Union Parisienne was established in 1904 by big private banking houses, which united in order not to be entirely eliminated.

The Banque Française pour le Commerce et l'Industrie was created by the former minister Rouvier; the Banque de Paris et des Pays-Bas and two great credit establishments: the Comptoir National d'Escompte and the Société Générale of Paris, the Württembergische Vereinsbank assisted at its establishment. These banks differ from each other, by their choice of issues, by the importance of the enterprises established, by their more or less close relations with the large private banks and the great credit establishments to which they hand over part of the shares which they hold and which they circulate through their numerous agents.

Lysis considers the "banque d'affaires" to be one element of the French financial market of which the great credit establishments are another, working in a different direction: "The Crédit Lyonnais, the Société Générale, the Comptoir d'Escompte have as their most essential task, the collecting of capital and the gathering together of an immense clientèle, which they ac-

quire by conducting banking operations for them at a reduced rate.

"It is here that the usefulness of the banques d'affaires, the Banque de Paris et des Pays-Bas, Union Parisienne, Crédit Mobilier appears. The functioning of these institutions is totally different from that of our credit establishments; they carry on no banking or stock exchange operations for small clients. Their rôle is only to seek out and conclude transactions abroad. Their administrative council is composed of representatives of the large private banks, all important men, having large fortunes, capable of supplying on demand several tens of millions. It is not only their money which constitutes their power. It is also their long standing clientèle of States and societies, their foreign connections, their correspondents and agents who work for them and who keep them informed of conditions all over the world. . . .

"In these circumstances, the division of labor in the consortium of the big banks is quite natural. The Banque de Paris, the Union Parisienne, etc., occupy themselves chiefly with the soliciting of business and especially of loans. . . . The great credit establishments, on their part, constituting a formidable bureaucracy, place these shares through the medium of their innumerable branches and agencies."

The issue of a foreign state loan, for instance, necessitated, before the war, the organization of a syndicate of vendors, which included the individuals and the "banques d'affaires," which had negotiated with the borrower. This syndicate took, according to Lysis, up to 5% of the amount of the issue as a commission. Besides this syndicate the bank which had charge of the operations constituted a *syndicate of guarantee* which insured the investment and which was formed by the big banks; their commission was also 5% according to the same author.

During the war, the activity of the banque d'affaires was necessarily reduced. Later they undertook to increase the capital for French enterprises, as they were no longer allowed to underwrite issues of foreign securities. A law of January, 1928, reëstablished the free circulation of capital in France. Several days later it was ascertained that the big Parisian banks were offering at Brussels, a large amount of capital on contango: it seems therefore probable that the French banques d'affaires will gradually

seek foreign operations again, along with the issues of National securities. The French financial press openly expresses this hope.

PRIVATE BANKS (LA "HAUTE BANQUE")

In France, as in the other countries, banking was, at first, carried on by individuals, possessing large capital. Certain of these banks maintained their position alongside the joint-stock companies. They are called "private bankers" (banquiers privés) and their aristocracy bears the name of "Haute banque." At the head of these latter is the house of the Rothschild brothers, which for a number of years has scarcely operated abroad at all, and has devoted itself to the management of the family fortune and that of great capitalist friends, although deriving profits from banking operations with the capital of foreign governments entrusted to it.

The true province of the house of Rothschild brothers, of Paris, has always been in financial transactions of a large scale and it has played an important rôle in the placing of foreign loans. (During numerous years, Messrs. Rothschild sustained the credit of the kingdom of Belgium until it had succeeded in firmly establishing its finances). This banking firm likewise assisted in establishing the French railroad companies. Even before the war, the placing of the securities representative of the loans extended by Rothschild was abandoned to the great credit establishments. The firm has large interests in important industrial enterprises, where it serves on the boards. One of the members of the Rothschild family is director of the Bank of France.

The management of the portfolio of the Rothschild Bank, constitutes an important occupation from which are realized direct and indirect profits: director's percentage of profits, dividends and appreciation of securities, the interest on cash and the coupons of the enterprises patronized. The Rothschild firm was considered, before the war, the largest buyer on the Paris market of the commercial bills, called "pensions," its portfolio reached the considerable sum of 500 millions and was composed only of commercial bills, provided with the signature of a Paris bank.

" In conformity with old traditions, a great number of foreign states and crowned heads had accounts with the great and discreet house on the Rue Laffitte. This is true also of members of the old aristocratic families and large capitalists, who had personal relations with the firm and entrusted it, as was the usage formerly, with the entire management of their fortune, with the most extended powers " (Kaufmann).

Beside the Rothschild firm, there is the Parisian " haute banque " composed of 6 or 7 old private firms, which resembled the English *merchant-bankers,* carrying on monetary transactions abroad, opening commercial credits overseas and participating in financial issues. They have lost much of their importance. The large private banking firms have, like the Rothschild firms, a clientèle of big capitalists and achieved appreciable revenue by assigning their heads to the boards of directors of large industrial companies and large investment banks. Occasionally before the war a distinction was made between the Jewish, Protestant or Catholic " haute banques."

Certain of these firms were important purchasers of " pensions," extended acceptance credits, carried on important discount operations or accounts current, and established limited liability companies.

The firms of Hottinguer & Co., Mallet Brothers and Co., Neuflize and Co., Demachy and F. Seillère were all represented before the war on the board of directors of the Bank of France; some of them are still so represented at the present time.

Beside the Parisian " haute banque " there exist around 150 private banking firms of varying importance, some of them very powerful. Some of them launch financial issues and occupy themselves especially with investment operations; many of them specialize in operations with one or more specified countries. Others arbitrage in drafts and the foreign exchanges; a good number carry on orthodox banking business: discount, accounts current and the acceptance of deposits.

Here one finds also a certain specialization, some firms handling only that business related to a specified product: wholesale trade in hides, pearls, diamonds, etc. Finally almost all of them manage private fortunes, make use of the funds of certain states and take " pensions."

In the provinces there is a certain number of rich private banking firms which occupy themselves especially with local industrial issues and loans on current account. These private banking firms often have a little network of 8 or 12 agencies.

Outside of these large private firms, there exists a considerable number of little bankers carrying on a business in current accounts and savings and serving as intermediaries between the merchants and manufacturers on the one side and the Bank of France or the large credit establishments on the other.

The Expansion of French Banks Abroad. We have studied briefly the French colonial banks and the foreign agencies of the great French credit establishments. The latter have established *subsidiary companies* abroad such as the Crédit-franco-portugais, Banque du Nord, established in St. Petersburg in 1901, Société Française de Banque et de Dépôt (Brussels), Société Swisse de Banque et de Dépôt.

Before the return of Alsace-Lorraine to France, the Société Générale Alsacienne de Banque, existed as a foreign bank, but with the same capacity as the Alsatian bank, having retained its French organization under German rule. It possessed 17 agencies; among them are one at Mayence and one at Frankfort.

The Société Française de Banque et de Dépôt is the Belgian subsidiary of the Société Générale de Paris. It has agencies in Belgium at Antwerp, Ostend and Spa, as well as its central office in Brussels. Before the war, it had opened an agency in the Netherlands at Rotterdam, and another in Germany, at Berlin. This was the first French bank to establish itself in that city since the war of 1870. The agency in Berlin permitted the Société Générale de Paris to participate indirectly in German financial affairs and to profit by the high rate of interest there. The agency in Berlin had the intention, on the eve of the events of 1914, of representing a certain number of Parisian banks in the German capital and proposed to have the German firms draw on the French banks directly and act as security for the credits granted.

In giving a general view of the French overseas banks before the war, Kaufmann writes:

" Outside of the French colonies, the French overseas banks play only a very modest rôle. That is due to the lack of spirit,

of enterprise, and of initiative, which characterizes the French banks in opposition to the German banks; this is explained likewise by the lack of importance of French maritime commerce as compared with that of Germany and of England. All of these banks, except that of Algeria, are moreover of recent date. Though there exist in the Mediterranean countries, in India and in Australia, agencies of the great deposit banks which survive with difficulty the competition of the foreign banks, their activities are manifest only in Algeria (which is economically independent of France), Eastern Asia and South America." To which it must be added that French banking expansion frequently expresses itself by participation in indigenous banks as in Roumania where the Bank of Paris and the Netherlands was interested in the Bank Marmorosch, Blank & Co. Ltd., with the Hungarian Bank of Budapest, the Berlin Handelsgesellschaft, and the Darmstädter Bank.

In Bulgaria, the Banque Générale de Bulgarie, established by the Bank of Paris and the Netherlands and the Maygar Commercial Bank, was in competition with the Banque de Crédit de Sofia, subsidiary of the Disconto, of the Norddeutsche and the Bleichröder.

In the Near East, the Ottoman Bank was established in 1863 by English and French Banks.

According to Kaufmann and Diouritch, the following is an approximate table of the French banking establishments situated outside of the Metropolis.

Name of the Bank	Number of Branches	Capital stock
Banque de la Guadeloupe	3	3,000,000
Banque de Guyane	3	600,000
Banque de Martinique	2	3,000,000
Banque de la Réunion	2	3,000,000
Banque de l'Afrique Occidentale	2	3,000,000
Banque de l'Algérie	6	1,500,000
Banque de Tunisie	16	20,000,000
Banque de l'Indo-Chine	3	4,000,000
Crédit foncier colonial	13	24,000,000
Banque Nationale d'Haïti	2	5,000,000
Banque de l'Afrique du Sud	6	10,000,000
Banque Nationale de St. Domingue	2	4,000,000
Compagnie Algérienne	16	25,000,000
Crédit Algérien	2	8,000,000
Crédit Foncier & Agricole d'Algérie	21	15,000,000

Crédit Foncier Egyptien	1	80,000,000
Crédit Foncier franco-canadien	3	4,784,000
Comptoir National d'Escompte de Paris	24	—
Crédit Lyonnais	21	—
Banco franco-argentino	1	125,000,000
Banque française du Rio de la Plata	1	80,000,000
Banque Argentine et Française	1	10,000,000
Société financière Franco-brésilienne	1	—
Société Commerciale française au Chili	1	—
Banque française et italienne pour l'Amérique du Sud	1	25,000,000
	154	453,884,000

FOREIGN BANKS IN FRANCE

The problem of foreign banks in France divides itself into two periods: before and after the war. The question of the relations of French banks with the foreign money markets is closely connected.

The criterion of nationality is determined by that of the directors and the owners of the majority of stock or by the principal center of exploitation rather than by the location of the principal office or the wording of the statutes. It is thus that there exists in Paris a subsidiary of the Belgian Bank " Crédit Anversois," called Crédit Anversois, Paris," constituted in the form of a French limited company but which is nothing more than a branch of the Belgian Bank to which it is subordinate.

Here are the statistics of the foreign banks in France according to Desmaisons:

Nationality	August 2, 1914	December 31, 1921
American	3	8
British	7	9
Spanish	2	2
Italian	1	2
Russian	4	5
Sundry	4	10
	21	36
French companies under clearly preponderant foreign influence	0	3
	21	39

The statistics of the American banks for the dates given below are as follows:

1914	1921
American Express Co.	American Express Co.
Equitable Trust Co.	Equitable Trust Co.
Farmers Loan & Trust Co.	Farmers Loan & Trust Co.
	Bankers Trust Co.
	Guaranty Trust Co. of New York
	International Banking Corporation
	Mercantile Bank of the Americas
	Park Union Foreign Banking Corp.[8]

The Mercantile Bank of the Americas and the Park Union Foreign Banking Corporation have, since, abandoned their offices in Paris. The National City Bank of New York took over the business of the Farmers Loan and Trust Company in 1922.

Furthermore, we should take into account the foreign private bankers established in Paris, such as Morgan, Harjes and Company, Munroe and Company, Hallgarten and Company, etc.

The American Express Company is considered as a bank in the French terminology, though it specializes in exchange operations. The Bankers Trust Company, installed in Paris in 1920, took part in the refinancing of the Industrial Bank of China.

Before the war, foreign banks were attracted to France by the abundance of available securities. In addition certain foreign firms centralized French indebtednesses in their countries. When they had gotten together a sufficient portfolio they installed a branch in Paris, in order to be able to negotiate their paper directly on the free market, below the rate of discount of the Bank of France.

Foreign banks were likewise attracted by the French market for long term capital. But it seems certain that the issue of stocks by the foreign banks in France has been very small: in any case, they have never been criticized in the very vigorous polemics which reproached the French banks with exporting the national savings.

Since the war, the reasons for the expansion of foreign banks in France, which attracted them in 1914, have been changed

[8] Dillon, Read and Co. are establishing the Dillon Read Corporation which will have an office in Paris.

somewhat by the restrictions placed on the free circulation of capital.

During the war, certain foreign banks were established in order to facilitate the Treasury operations of the national armies operating in the territory of the Republic. This movement slackened, beginning in 1920, though without ceasing completely. In 1921, the majority of the American banks in Paris had already been established.

The depreciation of the French currency attracted the banks of those countries with a normal exchange. With a relatively modest capital in dollars, American banks could carry on transactions to remunerate the expenses of the installation of a branch, hoping for large profits as result of the return of the franc to its full value.

The payment of international debts has become, likewise, a source of large profits, in consequence of the irregularities of exchange, to the banks established on the different markets.

The French balance of payments could be balanced during the period of economic and monetary troubles only by international credits: long term credits (foreign loans) or short term credits (bank credits). These short term credits, often called speculative credits, were built up by foreign deposits in France, converting foreign moneys into francs.

Finally, foreign banks, established in France, have contributed to the repatriation of a part of the foreign portfolio of the French capitalists and have likewise bought the stocks and securities of the French state at a depreciated rate, to profit by the high yield and the increase in value of these securities, once monetary reform is realized.

The legal regulation of foreign banks in France is in a special category: authorized companies of countries having treaties of reciprocity with the Republic in the matter of commercial companies, enjoy the same rights as the French companies. Those which are not authorized are, according to Dufourq-Lagélouse, considered as guaranteed companies and responsible for their actions to a third person: such as the "*Spanish Bank of Rio de la Plata*," because there is no agreement of reciprocity between France and the Argentine. The law of March 18, 1919, obliged the branches of foreign banks to register themselves in the register

of Commerce. The branches of a foreign bank in France may be placed in bankruptcy or liquidation under legal supervision, even when the law of the country of origin allows of a less severe treatment: a preventive agreement with the creditors (concordat préventif) for example. Such was the case of the *Banca Italiana di Sconto.* The foreign banks are admitted to the Bourse, to the clearing house; their discount negotiations and their acceptances are received at the Bank of France.

RÔLE OF FRENCH CAPITAL IN THE WORLD

It would be a remarkably interesting study to write on the rôle of French capital in the world. It is not permissible for us to attempt anything but a very vague outline here. Nevertheless, we should like to point out how easily the French banks joined with foreign banks, before the war, to exploit certain markets. Very early, the Deutsche Bank formed relations on the French market; in 1873, it financed the Parisian firm of Weisweiler & Goldschmidt; in 1887, this limited partnership came to an end.

In 1873, likewise, the Schaaffhausen'scher Bank Verein established a limited partnership in Paris, which it abandoned in 1887. In 1905, the German Uberseeische Bank, Speyer and Co. and a French bank organized an establishment in Peru.

From 1895–1902, a block of £22 million of the Chinese loan of 200 million taels was subscribed to in thirds by the French, German and English banks. In 1900, the Bank of Paris and the Netherlands participated in increasing the capital of the Banca Commerciale Italiana, with the Disconto Gesellschaft and Swiss and Austrian banks.

The repurchase of the Roumanian railroads, in 1879, was effected through the medium of the Bleichröder, the Disconto and the Banque de Paris des Pays-Bas.

Numerous Serbian, Russian, Portuguese, Swiss, Egyptian and Brazilian loans were launched by banking groups including the large French, Berlin and London banks.

This policy of mingling French financial interests with large international banking combinations was a necessary consequence

of the much criticized tendency of the French banks to place on the market large foreign loans.

FRENCH BANKS WITH A SOCIAL AS WELL AS AN ECONOMIC CHARACTER

We will group in this category a number of heterogeneous banks which, nevertheless, have a common trait: their origin and their modus operandi are related, in one way or another, to legislative intervention.

That is to say the legislature, at a given moment, voted a particular law, which gave birth to a credit establishment destined to fulfill a need of a group, or it gave an impetus to an institution already in existence. It may be stated in principle, thus, that these banks would not have existed without the help of the law, though this semi-official character does not prevent them from having an independent and purely capitalistic activity.

Crédit Foncier. We will study first the *Crédit foncier of France*. Until 1852, French mortgage credit (le crédit immobilier) was not organized, it was dispensed by notaries who used thus the funds entrusted to them by their clients. In 1852, a decree authorized the creation of companies making loans based on real property (sociétés de crédit foncier) with the privilege of issuing bearer bonds.

In December, 1857, the *Crédit foncier of France* was established, which, on July 6, 1854, was given an organization inspired by that of the Bank of France: an aristocratic assembly of the 200 principal shareholders which selects a board, assisted by three auditors. The governor and deputy-governors, who concentrate in their hands the management of the Bank are appointed by the government.

For many years, the *Crédit foncier* granted important advances to the communes, in addition to its mortgage operations.

In 1860 the *Crédit Agricole* was established, with the purpose of facilitating personal agricultural credits. From the beginning it coöperated with the *Crédit foncier* and launched into hazardous operations in Egypt. In 1877, the *Crédit Agricole* had to be

incorporated with the *Crédit foncier* which little by little disentangled itself from the Egyptian business.

In 1877, the *Crédit foncier* lost its privilege. But its semi-official organization caused it to be continued to be thought of as a public establishment. In reality it enjoyed an actual monopoly, due to the absorption of a rival establishment by the Parisian banks, which bound themselves by contract not to create any more establishments capable of competing with the *Crédit foncier*. Beside, the lottery issues of this latter institution are exempt from preliminary legal authorization and a number of communal loans are sold by its intermediary.

The *Crédit foncier* may issue debentures to an amount representing 20 times its capital. Loans are granted only on first mortgages. They may not exceed 50% of the value of the property and 30% if it is a matter of vineyards or forest. Their duration may not exceed 75 years.

The loans are made principally on urban property. According to Kaufmann, it was hoped, in the beginning, that the *Crédit foncier* would favor improvements of the soil, but this result has not been obtained. The *Crédit foncier* busies itself, moreover, with the issue of loans, advances on securities, on stock exchange orders. It accepts deposits at interest, of which the total, according to the terms of its statutes, may not exceed 100 million francs.

COÖPERATIVE AGRICULTURAL BANKS

Coöperation is relatively very little developed in France although it was regulated as early as 1867. "In it must be seen the principal cause," says Kaufmann, "of the relative affluence of the middle and lower classes and also of the position of the individualistic spirit of France."

A law of November 5, 1894, modified by later laws, authorized the establishment of agricultural credit companies, formed by members of syndicates of farmers or mutual agricultural insurance societies. These companies have for their exclusive object the facilitating and guaranteeing of operations concerning agricultural production effected by these groups or their members.

They may grant individual loans for a long term in favor of small rural enterprises.

These companies may receive funds in accounts current, make collections, and payments; they may contract loans to establish or to increase their working capital.

The capital may not be represented by shares; it must be formed by the subscriptions of the members of the company.

The law provides fiscal exemptions for these companies and prescribes conditions of special publicity. Nevertheless, until a law of 1899, coöperative agricultural credit made little progress, on account of the indifference of the farmers and the impossibility of discounting their bills at the Bank of France or the private banks.

A law of March 31, 1899, established the *Caisses régionales crédit agricole mutuel* (Regional banks for mutual agricultural credit), at the disposal of which were placed:

(1) A new loan of 40 millions which the Bank of France granted to the state without interest for the duration of its privilege (Law of November 17, 1897).
(2) The royalty paid by the Bank of France to the State and equal to $\frac{1}{8}$ of the rate of discount on the total of the productive circulation, with a minimum of 2 millions a year. From 1897 to 1913, the royalty yielded 82 millions.

The law of March 31, 1899, decreed that those sums should be placed at the disposal of the Caisses régionales de crédit agricole mutuel. The total of the advances may not exceed fourfold the capital; they may not be made for more than 5 years, but are renewable.

In 1911, the State obtained from the Bank of France modifications in the calculations of the royalty and beside:

(1) A supplementary free loan of 20 millions;
(2) A sum of 5 millions resulting from the retirement of an issue of notes.

These funds have been devoted to advances to popular and agricultural banks.

The Bank of France discounts bills of exchange drawn on the

local coöperative credit societies, and endorsed by the *Caisses régionales* (Regional banks), in the same way as warrants (dock or warehouse).

At the end of 1908, there were 94 regional banks (*caisses régionales*) with 2,636 affiliated coöperative societies, including 116,900 members. The advances amounted to more than 100 million francs. The president of the "Federation of the Regional banks for agricultural credit," was elected a regent of the Bank of France.

Other State Credit Institutions. During and since the war the establishment of credit institutions by the state has developed rapidly. Three establishments are particularly to be noticed in this field: the *Caisse foncière de Crédit* for the amelioration of housing conditions in industry, the *Crédit National* to facilitate the reparation of damages caused by the war, and the *Banque Nationale Française du Commerce Extérieur.*

Crédit National. The *Crédit National* to facilitate the reparation of the damages of the war was established in October, 1919, in the form of a limited company with a capital of 100 million francs. The public was not admitted to participate in this capital, which had been subscribed by the great credit institutions and the great industrial enterprises.

As with the governor and the deputy-governors of the Bank of France, the director-general and the directors are appointed by decree of the President of the Republic. The *Crédit National* may not receive deposits. It secures funds by the issue of debentures, the proceeds of which it devotes to advances on the indemnity allowed to victims of the war damages. In other words, this institution displaces the State in obtaining for the public the funds necessary for reparations. But beyond this, the *Crédit National* may grant loans, of from 3 to 10 years duration, "to facilitate the establishment, development or the reëstablishment of industrial or commercial undertakings." A time will probably come when the *Crédit National* will have closed all of the advances on the damages of the war; it is probable that then, it will serve as an organization having for its function the advancing of credits to French industry.

Societies for Mutual Security. There was likewise a disposition during the war, in France, as elsewhere, with attempting

to make it easier for the small craftsmen and tradesmen to obtain discount credits. The law of March 13, 1917, permitted the establishment of two organizations destined to perfect this. First of all was authorized the formation among merchants, craftsmen, commercial companies, etc., . . . of "*societies for mutual security*" (sociétés de caution mutuelle) having for their purpose, "the guarantee and endorsement of bills of exchange and notes made out, subscribed, or endorsed by their members, in proportion to their professional transactions." These societies reënforced by their signatures those of the members. The capital and the reserve funds are necessarily reserved for the guarantee of the bills guaranteed and endorsed.

People's Banks. The *popular banks* (banques populaires), established by at least seven subscribers, are authorized to receive deposits and to grant discounts or direct loans only to merchants, industrialists or manufacturers for business purposes. The Government granted the popular banks a loan without interest of 12 million francs.

Banque Nationale Française du Commerce Extérieur. Following in this field an idea common to all of the Allies, which were urged to imitate the credit organizations of Germany, the French government facilitated the establishment of a foreign trade bank: the *Banque Nationale Française du Commerce Extérieur* (French National Bank of Foreign Commerce).

The French National Bank of Foreign Commerce was one of the establishments born of the common desire of the Allies in matters of the exportation of capital and was in part the result of polemics devoted to this subject for more than twenty years.

This company has a capital of 100 million francs subsidized by the state. It is granted 2/3 of the royalty paid by the Bank of France to the Treasury as an annual subsidy up to 2 millions of francs and in addition loans without interest up to 25 millions.

The company, which has its office in Paris, may not establish either branches or agencies in France, but may establish them in the colonies or abroad. "Especially, in the cities where there already exist branches, agencies or subsidiaries of French banking establishments, the company must seek to form, at first, an agreement (or alliance) with these establishments, and, in case that such an agreement cannot be realized with any one of them,

the branch or agency may be established only in conformity with the judgment of the commissioners of the government."

One recognizes here the desire not to offend the susceptibilities of the large credit establishments and not to impede their transactions. Moreover of the 200,000 shares, a block of 16,666 shares must be reserved for them, which assures them of a large representation in the meetings, which the small shareholder almost never attends.

The object of the company is to carry on in the French colonies and in the countries under French protectorate or abroad, all banking operations and especially those which concern exports and imports. The State participates to a certain extent in the profits.

The Bourse. The Paris Bourse dates back to 1720, but its organization has been modified numerous times. It is not possible for us to trace its history and we must content ourselves with an exposition of its present organization. The organization of the bourses in the provinces is analogous to that of Paris. These bourses are of less importance and we will not occupy ourselves with them.

The stockbrokers of Paris, who enjoy a monopoly and have the sole right to carry on negotiations in public securities are 70 in number. These negotiations are made on credit or on account.

They are appointed by a decree countersigned by the Minister of Finance. They have the right of handing down their office according to set rules.

The stockbrokers must be French, must be at least 25 years old, must have fulfilled a term of probation and have taken an oath before the Commercial Court.

The stockbroker may take silent partners on the approval of the stock exchange committee and the Minister of Commerce. The stockbroker and his associates form a company of a special type, subject to special regulations as to publicity, and the resignation of associates. The liability of the partners is unlimited.

The firm of a stockbroker bears the name of the holder. He is rarely alone as the funds are contributed by the silent partners.

" In Paris," says Desmaisons, " the cost of being a stockbroker consists of a capital of 2,500,000 francs, divided into 100 shares of 25,000 francs each; 250,000 francs are deposited as security

in the vaults of the Treasury; about 1,000,000 represent the price of the charge and the rest is deposited, partly in the Bank of France, as a guarantee and security for transfers on current account, partly with the stock exchange committee."

"The holder of the trust (charge) must be the possessor of at least 40 shares, that is to say 10 shares representing the guarantee deposited in the hands of the Treasury and a third of the other shares. The remaining shares are divided among the silent partners who have the name of 'partners or stock-brokers.' The shares carry a right to an annual interest and a dividend if there are any profits; before the war, a distribution of 10 to 15% was considered a large dividend, and of 5% as average."

The company of 70 stockbrokers form the *parquet* (market) administered by the stock exchange committee. The company is responsible for its funds and securities and for the market operations of each of its members.

There is a certain specialization of operations.

Besides the *parquet,* formed by a corporation invested with a legal monopoly, there is established the *marché en banque* or *coulisse* and the *marché libre* (free market or market *hors cote* [outside the list]).

The *Coulisse* was established by the multiplication of the intermediaries, dealing with certain securities excluded from the official list of the *parquet,* and encroaching little by little on the prerogatives of the latter, in dealing with all securities and especially with national rentes.

In 1901, an agreement was concluded between the Coulisse and the *parquet,* under the auspices of the Minister of Finance, regulating the privileges of the two organizations, while perpetuating the legal monopoly of the stockbrokers.

The Coulisse is divided into two syndicates: that of "Bankers in securities on account" and that of "Bankers in securities on credit." Their organization is similar to that of the *parquet.*

According to the agreement of 1901, the "bankers" are considered, in as far as the securities admitted to the official list are concerned, in the same light as the *remisiers* (half commission men) of the stockbrokers.

Operations are carried on in fact in a large number of securities: those which the committee of stockbrokers do not judge

opportune to admit to the official list, and, on the other hand, those which do not have the right to be admitted since they do not fulfill the required legal conditions: foreign state funds, the admission of which is opposed by the Minister of Finance, shares or coupons for a sum smaller than that prescribed by the French laws.

"The financial market of Paris," writes Desmaisons, "presents thus a juxtaposition of two markets whose interests appear different and which, nevertheless, are not strangers to one another: the strictly regulated official market which occupies the interior of the Palais de la Bourse, the market 'en Banque,' the Coulisse, which does not enjoy any prerogative and which occupies the peristyle of the Bourse."

Beside these two markets there is another market entirely free: the market "*hors cote*" (outside of the list). Securities, not quoted, are the object here of the transactions of intermediaries, who are not subject to any regulation, or of the members of the Coulisse.

Numbers of securities begin on the market "*hors cote*," pass thence to the market "*en banque*" and finish finally by being quoted on the Parquet.

It is well to dissipate the confusions which exist on the subject of the market "*hors cote*." The securities which figure there are the object of an attentive supervision on the part of the Coulisse. Their price is inscribed in the "Statement of the extreme rates practiced on the market between members of the Syndicate on securities not quoted." This is what is called the quotation outside of the list (*hors cote coté*). These securities "are not admitted by the committee either because they do not have a financial standing sufficient to allow the committee to pass on their admission, when they have taken the necessary steps, or more simply because they have not demanded admissions, or, finally, because one of the conditions required for their admission is lacking."

Beside the "quotation outside of the list" (hors cote coté) there is the market "outside of the list, not quoted" (hors cote non coté). The rates of these securities offer no guarantee, no organization being qualified to receive and publish them.

The operations in cash permit payment and delivery within a

short period of time. The stockbrokers have a 15 days limit to deliver the securities.

The operations on credit (à terme) are those which are not closed until after a set period, called a settlement date (liquidation).

Settlement takes place on the Parquet the 15th and the last day of each month, and on the Coulisse, at the last market of each month only.

Admissions to the official list of transferable securities are declared after examination and study by a committee of the stock exchange.

Foreign securities are admitted only on the express authorization of the Minister of Finance, with the consent of the Minister of Foreign Affairs.

The official list is published each day at the close of the market under the title "Bulletin de la Cote" (Bulletin of quotations); it consists of two parts: the *official* section includes the securities recognized by the stock exchange committee. The French State funds are included by right. It distinguishes between the securities which may be negotiated in cash or credit from those which may be negotiated in cash only.

The second part includes securities not recognized by the stock exchange committee.

The Bulletin indicates at least the opening and closing prices as well as the lowest and highest ruling prices.

In that which concerns securities introduced on the market "en Banque," admission to the Coulisse is dependent on the decision of the syndicate of bankers in securities on credit, or the syndicate of securities in cash. Each of these syndicates publishes a Bulletin, appearing on market days.

The government, before the war, abstained from any interference relative to the admission of securities to negotiation in the Coulisse, so that foreign securities, refused by the official market for political or diplomatic reasons, managed, thanks to the Coulisse, to find a wide market in France.

In view of the interest which the Paris Bourse manifests in foreign securities, we will say a few words about their introduction.

Until 1880, the position of the government on the subject of the

admission of foreign loans was debatable. In 1880, a decree appeared reserving expressly to the Minister of Finance authorization for the negotiation of foreign securities in France. Nevertheless, a letter of the Minister to the stock exchange committee stated precisely that this right did not entail any responsibility on the part of the State. The stock exchange committee must demand the ministerial authorization, *after* having decided in principal the matter of admission to quotation. Thus, the authorization of the Minister of Finance is no guarantee for the subscriber to foreign securities.

During the war, under the reservation of the special derogations, the issue, exhibition, placing on sale or introduction on the market in France of rente certificates, loans, etc., of cities, companies, states, etc., . . . foreign or French was forbidden, in order to reserve the market for State loans. After the war, the restrictive regulation was maintained for foreign securities until 1927. At the end of this year, as we have indicated, liberty of circulation was returned to capital and negotiations were rapidly made for the introduction on the Paris Bourse of foreign securities, notably those of Belgium.

Since the return of peace, freedom has been reëstablished in all issues of securities of French enterprises.

CONCLUSIONS

The author does not try to conceal the insufficiencies of a work which does not aspire to originality and which has no purpose but to describe, depending on French sources, the banking system of France.

Since this study was undertaken, events have progressed and, in spite of the enormous difficulties which we have emphasized, the French government has been able to stabilize the franc without being forced to have recourse to a foreign loan. We have seen that this condition is of primary importance from the point of view of French policy.

The French banking system would certainly appear to be complete and endowed with all the necessary organization. The question is whether it will be able to accomplish the mission which

is assigned to it. But to express a judgment it is essential to understand the French mentality and to place in their environment the institutions which have been born of social as well as of economic conditions.

A banking institution, prudently managed, is always useful. But this usefulness may appear insufficient in the eyes of the observer who, depending on theoretic conceptions, will often perceive the faults of organization and the mistakes of general policy. Nevertheless, as the banks develop they are liable to yield everything to the preoccupations of income and prestige. The theorist may do them an injury, in pointing out the conditions of a better state. The recipient of credit, moved by interests identical with those of the bank, will have some difficulty in formulating impartial criticisms.

The lack of studies on pure banking theory is a great deficiency in French economic science. The insufficient scientific preparation of the publicists leads them to biased points of view and to exaggerations. The public, ill-informed, confuses effect and cause and carries the issue into the political realm.

This situation appears very clearly when studying the career of the "great credit establishments" which certainly dominate banking in France. If they tend to reduce the commercial rôle of the central bank, that is not a specifically French phenomenon: an inclusive study will show that in all of the European countries, the commercial rôle of central banks tends to be lessened in consequence of the concentration of capital in the hands of the large private establishments.

The multiplication of the limited liability companies, which modifies methods of financing, also exerts an influence in this field. In reality, the limited company tends to knit the close relations existing with the banks which grant them credits, which are often liquidated by increases of capital.

We are disposed to believe that this evolution will make its way in France likewise; the war divorced the French bourgeoisie from foreign securities for which they had shown an exaggerated propensity. Savings not directed to the formidable loans of the State, will be turned to French industrial enterprises the needs of which the monetary depreciation has accentuated. Hence, the important issues of French industrial securities, which are, per-

haps, one of the causes of the renaissance of the regional banks. This renaissance is probably less marked than the panegyrists of decentralization would wish it; it is nevertheless undoubted and coincides with the industrialization and electrification of France. Will it be permanent? It is hazardous to formulate a prophecy; one may however profess some scepticism in this regard, in reflecting on the development of banking concentration in the other countries of Europe.

Nevertheless, considering it near at hand, this recrudescence of regional banking is a consequence of this same law of concentration; perhaps the development of the regional banks paves the way for a new movement of centralization in which the business banks will play a more active rôle than the great credit establishments.

On the other hand, these continue to extend their network of agencies in the provinces and the return to a free circulation of capital will perhaps be the signal for a new development.

CHAPTER VIII

THE BANKING SYSTEM OF GERMANY

BY

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Translated by DR. ANNA YOUNGMAN,
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HISTORICAL DEVELOPMENT

INTRODUCTION. Few old states can boast of a development of their currency and banking systems during the last fifty or sixty years comparable to that of the German Empire. In the years succeeding the establishment of the Empire, the banking system assumed definite shape. The war years which followed were accompanied by a self-destructive inflation expressing itself finally in figures of astronomical magnitude and in a valueless money. After the stabilization of the mark an industrial revival commenced which has brought about (end of 1927) a return of normal conditions of work.

The upward movement which began with the founding of the Empire in 1871 and proceeded almost uninterruptedly until 1914 could not have started at so swift a pace if antecedent developments had not prepared the way. This development can be observed from about the year 1848 — the date that marked the revulsion from particularism. Before that time almost no traces of modern industrial organization are to be found in Germany due largely to a chain of circumstances resultant from the Thirty Years' War. And these historical facts must not be ignored in a strictly economic survey of the present time, for they largely explain why German economic development in the last fifty or sixty years bears a certain resemblance to that of America in spite of existing diversities. They explain also why it has been quite different on the other hand from the conservative progress characteristic of England or France whose past was not so com-

pletely swept away as, for instance, was that of the German Hanseatic towns or the south German trading cities (Augsburg, etc.).

1848–1871 — The Time of Preparation. By a purely superficial coincidence, the year 1848 witnessed the establishment of the first German joint stock bank, the A. Schaaffhausen'scher Bankverein in Cologne. It was, however, far more significant by reason of various political developments. As a result of the contest for supremacy between Prussia and Austria, the German Confederation (Bund), remained until 1866 in a state of perpetual political unrest. But even though this was true in the political world, a far-reaching inter-state economic assimilation occurred during this period. The multiplicity of currency standards grouped themselves slowly around the Prussian taler on the one hand and the Austrian gulden on the other. Even more important was the customs union (Zollverein) founded in 1862, and the creation of uniform German codes of commercial law and of bills of exchange (1863). After the withdrawal of Austria from the German Confederation in 1866, unification advanced still more rapidly; in 1867 the North German Confederation was formed which eventually ended in the founding of the German Empire (January 18, 1871).

From the Foundation of the Empire to 1914. The establishment of the Empire inevitably led to the creation of certain institutions which would to-day be called the results of rationalization. It brought with it a centralized postal system, as well as an imperial system of finance and of law. It also led to the founding of the Reichsbank by an imperial law of 1874 and to a transition to the gold standard, a change which was greatly facilitated by the French war indemnity. From this time until 1914 Germany was among the few countries which possessed a pure gold standard. Until 1900 there remained as part of the system an unimportant survival of the previous silver standard régime in so far as a limited amount of silver talers were left with full legal tender powers. The amendments to the currency law of June 1, 1900, eliminated this feature. At no time prior to 1914 was the German currency standard threatened. Influenced perhaps by the prevailing historical trend of economic thought in Germany (in contrast to the quantity theory of Anglo-Saxon

countries) the German standard of value was quite generally regarded as unshakable, an assumption that goes far to furnish an explanation of the events of the years after 1914.

THE GROSSBANKEN. In the decades that followed, as is well known, the advance of industry and of the Grossbanken proceeded hand in hand, — a development surpassed only in America. Overseas banks were established as offshoots of the leading Banks, such, for example, as the Deutsch-Suedamerikanische Bank, the Deutsch-Asiastische Bank, the Deutsche Orient Bank, etc. Favored by a boom period which lasted from 1893 to 1900, the Berlin Grossbanken reached a position so secure that the crisis of 1900 not only did not harm them but they were able, through quick intervention, to localize it in part. In the following year indeed the Deutsche Bank took at one time 200,000,000 marks in Reich loans and Prussian consols. This marked the beginning of a period of supremacy for the German Grossbanken which continued down to the outbreak of the war. The period from 1909 to 1912 witnessed negotiations between the Reichsbank and the Grossbanken which led to the publication of balance-sheets every two months according to a uniform schedule. The efforts of the Reichsbank to increase the responsiveness of the German money market by inducing the Grossbanken to add to their cash resources also met with success. On the other hand, it was not possible to increase at once the external liquidity of the German money system by building up the gold or exchange resources of private banks.

THE WAR PERIOD AND THE INITIAL PERIOD OF INFLATION OF THE POSTWAR ERA. 1914–1922. Immediately after the outbreak of the war (August, 1914) a number of important modifications of the currency system were announced by imperial decree. Only a few of these and of the other ordinances that appeared from time to time during the course of the war need be mentioned here. Those that intimately affected the activity of the Reichsbank will be discussed in connection with that institution. The most important of the ordinances appearing in August, 1914, provided for the suspension of the redemption in gold of the notes of the Reichsbank, the admission of Treasury obligations as note cover (by which act the door was thrown wide open to inflation) and the creation of war loan organizations (Kriegsdarlehens-

kassen). These were intended to mitigate the unavoidable hardships which the war brought to the economic life of the country.

Discount Policy of the Reichsbank. The Reichsbank pursued a very different course from that of the Bank of England in its discount policy. It confined its action to an advance of the bank rate from 5% to 6%, which was reduced again to 5% in December, 1914. At the same time the Bank tried to strengthen its gold reserve, which at the beginning of August, 1914, stood at 1,253,000,000 marks, by withdrawing coins from circulation. By such means, and because of the willingness of the people to make the necessary sacrifices (" gold I gave for iron "), the Reichsbank succeeded in raising its gold reserve to 2,100,000,000 marks, while in the following years the total was slowly brought to approximately 2,500,000,000 marks. Only a relatively small amount of gold was expended for imports from neutral countries. It is estimated that the deficit on foreign trade account during the four war years amounted to about 15,000,000,000 gold marks, of which 1,000,000,000 was covered by an export of gold, 3,000,000,000 through exports of the securities of neutral countries, and 1,000,000,000 by the sale of domestic securities. The remainder of the trade deficit, about 10,000,000,000 gold marks, is roughly estimated to have been represented to the extent of one-third of the total by exchange credits, while the other two-thirds was offset by the contraction of debts in marks or liquidated by the sale of mark notes abroad. The withdrawal of metallic money and the great need for currency for use by the troops offered an opportunity for issuing private emergency notes (Notgeld). Full cover for such issues had to be maintained in a closed account at the Reichsbank. During the war these private note issues may not have played any very important rôle; nevertheless they fostered the germs of the unhealthy excesses that occurred in the field of private note issues in the inflation years that followed.

Initial Inflation Camouflaged. Up to the time of the Armistice Germany and her allies resembled a beleaguered fortress. There was for that reason less opportunity for individuals to appreciate the danger of the initial signs of inflation, especially as certain circumstances tended to confuse the judgment of the experts themselves. The scarcity of all sorts of consumable goods, which soon began to be felt, would naturally have led, even

with a stable money volume, to a rise in prices. This rise is easily comprehensible, and it was all the more conspicuous because of the fact that goods for which the demand did not rise (real estate, for example) fell at first in price. In the period from 1914 to 1918 there was no trace of the commodity value theory ("Substanztheorie") which later came to be so generally accepted in the States suffering from inflation. Isolation from the outside world was emphasized by the introduction soon after the beginning of the war of prohibitions upon dealings in exchange imposed to protect the stability of the currency. This resulted eventually in 1916 in a central administration for all foreign payments. Since the mark was simultaneously supported in neutral centers by the intervention of the Reichsbank, a completely false picture of the position was presented to the public. As a matter of fact, inflation made tremendous strides even during the war years because Germany, in contrast to England, did not defray its war costs by tax increases but financed them exclusively by loans. By the end of the war these loans amounted to about 100,000,000,000 marks.

Sources of Inflation. In addition to the growing direct resort to the printing press by the State (discounts of Treasury bills to the end of the war totalled about 19,000,000,000 marks), there existed a number of other sources and means of inflation. The "Kriegsdarlehenskassen" named above, whose issues were admitted as a cover for bank notes, granted few credits for industrial purposes, it is true, perhaps 500,000,000 marks. However, as a large part of the advances against war loans were placed with them they had issued approximately 13,000,000,000 marks of their own notes by the end of the war.

At the same time the German Empire, like England, being the strongest financially among its allies was soon forced to make advances to its three associates.

Another source of inflation was created by the fact that the war loans of the state naturally had to be recognized as security for advances. The consequence was that each new loan was floated upon the basis of loans obtained by the pledge of earlier issues — a circle which in view of the blockade might have continued to exist indefinitely.

Occupation Money. In order to relieve the Reichsbank, it

was soon decided to issue occupation money (Okkupationsgeld) in occupied territories in place of the local currencies. At the end of the war, about 5,000,000,000 marks of this money was in circulation. This currency was secured by specific pledges with the Reichsbank of mark deposits by the issuing institutions (for example in Belgium the Société Générale). The regulation of these occupation currencies was largely provided for by the Armistice or in the Peace Treaties, while in South Russia the newly created Karbovanietz vanished altogether. Only the question of the occupation money issued in Roumania (notes of the Banca Generala) still remains unsettled.

Fluctuations in the External Value of the Mark. All this time, during the vicissitudes of war, the Reichsmark was maintained in Zuerich at a quotation of 85 centimes at the end of 1916; and of 86 centimes at the end of 1917. Just before the collapse on October 1, 1918, it was still being held at about 70 centimes, but by December 1, 1918, it fell to 66 centimes. In May, 1919, it stood at 45 centimes and by December, 1919, at 12 centimes, compared with a par of 123.5 centimes.

The Effect of the Reparations Controversy on the Mark. During the peace negotiations it soon became apparent that France, especially, was less bent upon obtaining payments that were practically possible than upon throwing Germany into a condition of permanent servitude as a debtor. Consequently the chief support of any currency system, namely, the credit of the state, was completely undermined. The sovereignty of the state (in customs matters through the "Hole in the West" and the forced grant of most-favored-nation treatment over a five-year period) was so restricted that all the efforts of the government (payment of customs in gold, seizure of war profits) in the period that followed were from the start rendered futile. The Dawes Plan, to which Germany owes its salvation, put an end to this situation. Up to that time the reparations policy of the western states remained almost the only determinant factor in the German currency problem. If the Brussels Conference brought about a noticeable relief to the exchange markets, the failure of the London conference in March, 1921, led, on the contrary, to a more pronounced fall in the mark. For the reasons set forth, it is evident that it would be useless to try to connect the development of the German currency system from 1919 to

1923 with any theories of money. While the quantity theory achieved triumphs in all other states during the postwar years, German experience seemingly appeared directly to contradict its validity.

Climax of Inflation (1923). Inflation remained within bearable limits following the Genoa Conference until after the death of Rathenau, on June 24, 1922. Its death-blow was received through the Ruhr invasion and the period of passive resistance.

The " Hole in the West," already established by the regular occupation, was widened by the Ruhr invasion to such an extent that from this time on the entire efforts of the government and the Reichsbank were employed to combat the progressive demoralization with only paper measures available. It was but characteristic that for a long time after its appearance the circulation of the rentenmark was forbidden in the occupied regions by the occupation authorities. Apart from this purely technical question, the immediate consequence of the Ruhr invasion was a complete demoralization of the State budgets as a result of the necessity of appropriating relief funds together with the loss of the taxes paid by this rich district. The great majority of the people who had been accustomed by a tradition developed through decades to cling to belief in the mark, were overcome by a feeling of apathy and of despair, ruled by the thought that a bad ending was to be preferred to constant alarms and apprehension.

To-day, with all these events past history, informed circles quite generally are of the opinion that many of the sufferings of the inflation era might have been avoided. It was a fact of decisive importance that until the end of 1922 the Reichsbank was completely subordinate to the state and even later, for reasons personal to the old management, there was no change in policy.[1] Above all, not enough effort was made to control the private note issues which finally rose to grotesque figures. Until the final months, nothing was done to prevent the placing of mark credits abroad, although such currency, practically speaking, could no longer provide the basis for any real transaction with foreign countries. Such credits, therefore, only tended to throw additional funds into the hands of foreign speculators.

[1] On this point see the discussion in the Chapter on the Reichsbank.

At the beginning of 1923 the dollar was equivalent to about 20,000 paper marks, while at the end it was quoted at 4,200,000,000,000. As a substitute for a standard now useless in long-term credit operations, there appeared a type of commodity value loan (Sachwertanleihe). Its stability was assured after a fashion because interest and repayment of principal were fixed in terms of a given quality and quantity of a specific commodity. The commodity thus selected was often economically important to the debtor; for example, for agricultural loans, rye, and for the Prussian state as owner of extensive mines, potash.

End of the Paper Mark. Finally, at the end of October, 1923, the paper mark had to be abandoned. In the interval preceding the issue of the rentenmark, industrial chaos reigned, while people tried in various ways to protect themselves against the daily depreciation of the paper money. In order to bring prices into some sort of relation to gold values, a daily coefficient was announced — that is, a multiplier with which to convert basic prices (already fixed to a certain extent in gold) into paper. This had as a tragi-comic result that prices quoted in the morning immediately before the publication of the new multiplier often amounted to only about one-third of the real price reckoned in gold.

In addition to the paper mark, private emergency currencies were used as means of payment. These latter issues were in some cases based upon stable values, especially the so-called dollar treasury notes. To cover expenditures and create a provisional kind of currency the government floated a stable value loan (wertbestaendige Anleihe) in the form of dollar treasury notes of which the smaller denominations, non-interest bearing, were made equivalent to $1.00 for 4.20 gold marks, $2.00 for 8.40 gold marks and $5.00 for 21 gold marks. Thus the paper money was officially repudiated by the State itself. Among the serious private efforts to create provisional means of payment, chief credit should be given to the attempt of the Hamburger Bank in 1923. Secured by a reserve in foreign exchange, the bank issued notes and metallic money and also negotiated credit transactions in gold. Various similar attempts, characteristically limited to the neighborhood of the Hanseatic cities, are of lesser importance. It is estimated that when the rentenmark was introduced, the circula-

tion of paper marks (Reichsbank notes) had a value in exchange of perhaps 300,000,000 to 400,000,000 gold marks and that private note issues were about twice that amount. Half of the latter rested upon a stable value basis.

THE RENTENMARK. The rentenmark may be regarded as a hybrid between the resort to goods value and the assignats of the French Revolution. Largely the outcome of a plan devised by Helfferich, the rentenmark made its appearance in October, 1923. The instrumentality through which it was issued was the German Rentenbank. As the rentenmark laid the foundation for the German monetary system, it is necessary to describe at this point some of the details of its establishment.

CREDITS OF THE RENTENBANK. The original capital and reserve of the German Rentenbank to the amount of 3,200,000,000 rentenmarks were raised through a general mortgage placed upon landed property. The " stable value " rentenmark, valued as the equivalent of 1,000,000,000,000 paper marks, was issued in the following manner: First the Bank made the mortgage debt incurred in its favor the basis for the issuance of interest bearing bonds which served as security for the rentenmark. The latter currency was then given legal tender power along with the paper mark. The rentenmark notes were subsequently put into circulation. The Rentenbank granted a credit of 1,200,000,000 rentenmarks to the Reich and advanced to agriculture and industry another 1,200,000,000 rentenmarks via the Reichsbank. The remaining sum of 800,000,000 rentenmarks was used to build up the capital and reserves of the bank. Simultaneously with the apportionment of credits through the Rentenbank, the credit demands of the State upon the Reichsbank had to cease. Hitherto such loans had taken the form of a discount of treasury notes. But now the printing press was stopped.

The gradually awakening conviction of the victorious States that larger payments could only be expected from Germany on the basis of an orderly currency system afforded further support for the successful effort. It was this conviction that finally led to the adoption of the Dawes Plan, on September 1, 1924, over three quarters of a year later.

The relationship later established, which made one trillion paper marks the equivalent of 1 rentenmark, 1 gold mark and

1 reichsmark, was not fixed, it should be noted, prior to the issuance of the rentenmark. If a fixed relationship had been established at the start, the rentenmark would have been subjected to all the dangers that beset the paper mark. The eventual relation established, made easier by the simple proceeding of striking off 12 ciphers, is partly explained by the conditions which the rentenmark encountered upon its appearance in foreign exchange markets and in the occupied territory. It was due in part also to the fact that the dollar treasury bills of the Reich were issued at a ratio of $1.00 for each 4.20 gold marks.

Battle of the Rentenmark. The rentenmark, which after all represented an attempt to lift oneself by one's boot straps encountered some perils at the start. In neighboring markets (Amsterdam, Cologne, etc.) removed from German intervention, the dollar rose from its accepted parity of 4.20 gold marks to over 12 marks during November, 1923, and some months later a renewed brief attack upon the new currency was made by international speculators. In both instances, however, the energy of the new management succeeded in restoring it to parity.

It was a matter of great importance that the rapid establishment of the new German currency should have resulted in shattering plans already far advanced for founding a Rhenish Westphalian Gold Note Bank. Systematic credit restrictions enforced by the Reichsbank began in April, 1924, and continued undiminished into July. This measure was needed to root out all the abnormal growths of inflation and to overcome the assaults of both domestic and foreign speculation. During these months there were many critical moments when first the economic structure and then the new currency seemed on the point of collapse. While the Reichsbank — still the center for all requests for foreign exchange — was only able to apportion 1% of the applications received in April, 1924, it finally succeeded in starving out the speculators and forcing the domestic producers to draw on their stocks and their supplies of foreign exchange, with the result that at last, in January, 1925, 100% could be allotted. This was accepted as a sign that the crisis had been successfully survived.

From April until July, 1924, the wholesale trade index fell from 124 to 115 points.

THE RISE IN INTEREST RATES. Hand in hand with the economic crisis, which lasted with ups and downs through the year 1925 and into the early part of 1926, went a great rise in domestic interest rates. In the critical months preceding July, 1924, the rates for monthly money rose to 30–40% per annum and for day money they were twice as high. The climax of this crisis may be said to have been reached with the crisis in the affairs of the Stinnes concern, and thereafter, there ensued a period of exhaustion. The chief reason for the collapse of a number of great concerns, at least in the West, was the excessive expansion undertaken without the slightest regard for working capital needs. In the East (Upper Silesia), it is true, the desperate situation created by the breaking up of industries was partly responsible. It is easy to understand why, during the previous months, these giant concerns worked without liquid resources, since their cash funds were daily depreciating. With the success of stabilization, there was no drop in interest rates because of the universal credit shortage, and because of the temporary reluctance of foreign money lenders to enter the German market. Inevitably the excessive credits had to lead to a catastrophe sooner or later. A period of two years was required before industries were able to accumulate out of their own resources and from foreign loans enough liquid capital to replace that which had been completely destroyed by inflation.

In this same period the financial reconstruction of the German industrial structure was completed. Its most important landmarks were the laws establishing gold balances and providing for revaluation (die Goldgesetzgebung and die Aufwertungsgesetzgebung).

RECONSTRUCTION OF GERMAN ECONOMIC LIFE. Stabilization found German industry in a condition of fearful impoverishment and this was particularly true in the case of liquid resources of every kind (working capital, cash on hand, etc.) During the inflation years, replacement of working or, as Adam Smith would say, circulating capital had not kept pace with currency depreciation and had, besides, been deliberately neglected (flight to material values as, for example, houses, goods and chattels, etc.).

Disappearance of Circulating Capital. The following table shows how circulating capital disappeared.[2] Funds owned and controlled by German financial institutions at the close of the inflation period as compared with 1913:

	1913	End of 1923
	(in billions of gold marks)	
Savings Banks	19.7	0.1
Banks	13.4	2.7
Coöperatives	4.6	0.4
Insurance Companies	6.3	1.2
Total	44.0	4.4 that is 1/10

Reconstruction Measures. There is not room here for a thorough treatment of all the events and all the various legal measures which finally brought the German economic structure to its present promising state of development after the fearful ravages produced by the World War, the Peace Treaty, and inflation. But among the topics which will receive more detailed treatment are two which rightfully enlist a good deal of general interest: first the method of revaluing debts contracted in paper marks and, secondly, the conversion of company balance sheets from paper marks to gold marks (Goldbilanzen).

These two measures constitute in fact the main props of the reconstruction program. The system of gold balance-sheets was more or less followed by a number of other countries likewise injured by inflation such as Austria, Hungary, and more recently Czechoslovakia. On the other hand, the revaluation measures had almost no imitators. There is no doubt that German industry did itself the best possible service by the introduction of systematic revaluation undertaken at first solely in the interest of justice. As will be made clearer by subsequent discussion, revaluation brought some, if very slight, compensation to completely impoverished small investors and to the middle class. The question of revaluation for this reason acquired predominant political importance, especially in the elections of 1924, and contributed greatly to the consolidation of the domestic situation.

Gold Balance-Sheets. Gold balance-sheets became an inescapable necessity as a result of inflation. Immediately after the

[2] Dr. Schacht's "Stabilisierung der Mark."

stabilization of the mark in December, 1923, the government issued an ordinance officially confirming the completion of the transition to gold mark balance-sheets. As a matter of course, all well managed undertakings had long since established internal accounts on some sort of stable value basis (whether in gold marks or in a foreign currency) in order to keep track of their actual condition. According to the ordinance establishing gold balance-sheets, all tradesmen required to keep books of accounts must from January 1, 1924, the beginning of their new business year, state inventories and balances in gold marks. Furthermore, the initial statement was to be set up in the new form independent of the previous paper mark accounting. The most important provisions of the measure of December 28, 1923, and the subsequent enforcement ordinances relating to gold balances of joint stock companies, may be summarized as follows: the capital in gold marks (Reichsmarks) is defined as the excess of assets over debts and other liabilities with exception of the capital account. The capital resources thus defined might be apportioned between capital and reserves as desired. The legal maximum reserve fund, however, could not exceed the amount of the capital. The previous relationship between capital and open reserves was therefore of no importance for the division of property in gold marks. The share capital as thus determined had then to be brought into relation to the existing nominal capital and to the amount of paper mark shares outstanding. Almost all companies during the inflation years had watered their capital stock, although in very unequal degrees. Consequently, the equitable interest in the capital represented by one single paper mark share in the majority of cases was much too small to serve as the basis for future share units. It was therefore necessary to combine shares. In order to limit the necessary process as much as possible for the sake of protecting small shareholders, the legally permitted nominal value of future share issues was much reduced as compared with pre-war times. Whereas in the pre-war period the average share had a nominal value of 1,000 marks, the smallest nominal value set for the purpose of the gold balance-sheet was 20 marks, therefore identical with the usual face value of English shares, £1. It was also provided that after two years the nominal value of a share should be raised to a minimum of 100 marks — a provision which is at

present (1927) the subject of active public discussion. During the transition period all nominal values representing a multiple of 20 or 50 were permissible up to 250 reichsmarks. Above that amount conversion had to be made into amounts divisible by 100. Especial protection was accorded in connection with the arrangements for uniting overlapping fractions of shares. In practice business concerns have made little use of a number of the clauses of the gold balance legislation such, for instance, as the sections relating to capital depreciation accounts, conversion reserves, etc. Special regulations were provided for the conversion of preference shares which did not share equitably in the property of the business. In such case the gold value on the day the shares were paid up served as the basis of conversion. Still other provisions applied to shares with multiple voting rights, such as the so-called treasury shares (Vorratsaktien), that is, shares at the disposal of the company. The lower limit of capital after conversion could not fall below 5,000 gold marks while, in the case of new undertakings, 50,000 gold marks was required. For companies whose shares were already traded in on the bourses, the permissible minimum was 200,000 gold marks, while, for those not previously admitted to trading privileges, the original capital was fixed at 500,000 gold marks.

Law Regulating Gold Balance-Sheets. This brief summary will have to suffice. It naturally offers no complete survey of the legal provisions of the gold balance-sheet ordinance, and it ignores the conversion difficulties and the accounting problems that have arisen in practice. The losses which German industry and economic life had suffered were revealed by the gold balance-sheets. Now, two or three years later, it has become possible to obtain a certain perspective on the results of the gold conversion. There are, to be sure, cases in which an establishment has overestimated its future earning powers, possibly because of the fact that a severe business crisis followed the period in which gold accounts were reëstablished. In isolated cases it has become necessary to make revisions involving a reduction of the share capital as determined by the gold balance procedure. In the overwhelming majority of cases, however, the return to gold resulted in establishing a correct or, from motives of prudence sometimes, a too small capital value. The German system of quoting in percent-

ages makes it possible to determine at once whether the bourses, which offer the best measures of value, estimate the capital of a company to be higher or lower than the amount of its nominal share capital. German company shares quoted on the bourses stand almost without exception above parity. The average for all shares quoted on the Berlin Bourse in the middle of September, 1927, was 169.2%.

Earnings afford another test of the gold balance-sheet conversion scheme. The average returns of about 1,000 companies whose shares were quoted on the Bourse was 3.5% in 1926; after elimination of those concerns which paid no dividends, the return was 5.5%. These results may be considered thoroughly satisfactory in view of the fact that the first months of 1926 fell in a crisis period.

Revaluation. Inflation led to the complete devaluation of all long-term debts contracted in paper marks, especially where the creditor was prevented from demanding in time the return of his money. In order to make this clear, it may be recalled that in the pre-war period, the gigantic sum of about 40,000,000,000 marks (about one-sixth of the property of Germany) represented debts secured by landed property, private mortgages, mortgage bonds, etc. After stabilization, with the mark standing in a relation of one trillion to one to the rentenmark or gold mark, this total corresponded to four pfennigs or one American cent. Although elementary conceptions of justice dictated rejection of such conditions, the decisions of the German courts until the middle of 1923 rested upon a principle that had become a proverb: " A mark is always equal to a mark " (Mark ist gleich Mark). It did not matter what was the actual purchasing power or what the real money value at the time that the debt was contracted and amortized. Other countries suffering from a lesser degree of inflation were able to modify some of the most inequitable results of depreciation by special laws so that revaluation in such instances acquired a sort of benevolent character. Austria, for example, clung in general to the principle that a " crown is a crown " in spite of its depreciation to one fourteen-thousandth of its original value. However, for all services which related to maintenance costs, such as life insurance, legacies, etc., within the family, revaluation as determined

by the courts was permitted. More thorough-going measures were essential in the case of Germany with an inflation that had degenerated into figures of astronomical proportions. After other courts had set the example, the Reichsgericht in November, 1923, in a mortgage dispute, finally declared in favor of revaluation, recognizing the right of the creditor to have his claims in paper marks revised, with reasonable reference to the ability of the debtor to pay. The ordinance of February, 1924, next followed, furnishing a much disputed issue in the Reichstag elections in 1924, and finally taking shape in the revaluation law of July, 1925. This law was supplemented by another one relating to the revaluation of state loans passed the same day. The main provisions of the revaluation measure are as follows:

As a matter of principle and, in general, revaluation was declared to be allowable, with the assumption that the good faith (Treu und Glaube) upon which the civil code is based would be controlling. For the regulation of a number of typical cases of debt, of which there were thousands substantially similar, the law fixed valuation rates which superseded the " good faith " principle. Finally the law expressly declared that certain kinds of debt relationships were not subject to revaluation. Among these are current accounts and bank deposits, exclusive however of savings deposits. There are innumerable special provisions besides the principal sections covering exceptions, concessions to the creditor, favors to the debtor, etc., whose recital would take too much space. The most important of the revaluation rates " Aufwertungssaetze " range as follows: For all government debts, as well as the debts of the *individual* states, the revaluation rate is generally 2½%. In case of the loans of the Reich however, the redemption right is subordinate to reparations obligations; hence, it is only a sort of future recovery certificate (Besserungsschein). An exception from this rule was made for the old holders of the government loans, that is, for those who had acquired their securities prior to July 1, 1920, and had held them uninterruptedly since then. For these old holders, revaluation at five times the usual rate was permitted, that is, 12½%. This " old " loan has taken the form of a redemption loan (Abloesungsanleihe) which, in contrast to the new holdings, carries interest at 4½% and is redeemable within thirty years. As the " old "

holdings loan is to-day quoted around 55, its owners have received on the basis of present sales value approximately 7% of the amount of their original investment. Especial provision is also made for impoverished old holders who may receive an income for maintenance varying in relation to their holdings, reaching an annual maximum of $200.00. The provisions concerning provincial and communal loans are in principle similar to those governing the Reich loans. Nevertheless, in the case of the loans of the communes whose property in many instances greatly increased in value through inflation, certain changes have been made in favor of the creditors. Industrial obligations (bonds) were revalued at the rate of 15%. In addition, old holders (see definition in case of the Reich loan) were given a 10% participation right on which interest and amortization varied with the dividends paid by the debtor company. Private mortgages were as a rule valued at 25% of their original gold value (with certain provisions designed to protect the debtor against special hardships). The provisions relating to the revaluation of mortgage bonds (Pfandbriefe) issued by mortgage banks (Hypothekenbanken) are particularly complicated, because in such cases a large number of debtors confront a large number of creditors (the owners of the Pfandbriefe). The method selected was to establish a participation pool (Teilungsmasse) to be apportioned by the mortgage banks among the holders of the mortgage bonds. In similar fashion, revaluation was carried through for savings deposits and for insurance funds. Further details of especially characteristic proceedings in connection with revaluation will be discussed more fully in the chapter dealing with the mortgage banks.

A BRIEF SURVEY OF THE BANKING ORGANIZATION

While all details of the various types of banks will be discussed in the following pages, it seems necessary at this point, in order to avoid any misconception, to give a brief summary of the characteristic features of the German banking system.

Note-Issuing Banks. In consequence of a compromise between the strong imperialistic ideas which prevailed after 1871

and contemporaneous federalistic influences, the German system of bank note issue made such progress in the direction of centralization that finally only four private banks of issue besides the Reichsbank remained.

Public Credit Institutions. As an outgrowth of the same set of circumstances that developed the specifically German form of central bank of issue, with its five hundred branches, Germany possesses a large number of public credit institutions differing from one another in organization, clientèle, etc. They owe their origin in good part to the industrial conditions prevailing in the paternalistic states of the eighteenth century, and to the initiative of their rulers. They are indeed the oldest of the German credit institutions. Others arose later as various additional tasks were imposed upon the State. When, for example, the peasantry were freed from their feudal burdens in the middle of the nineteenth century, the establishment of the Prussian Rentenbanken followed as an aftermath. Then came the settlement movement at the close of the nineteenth century. Finally, some of these public institutions — in scope by far the greatest — have arisen in connection with the reconstruction of German industry after 1923 (Gold Discount Bank and the Rentenbank-Kredit-Anstalt). In spite of great differences in structure, explicable on historical and particularistic grounds, a very few branches of activity are typical of these institutions, such as handling the monetary affairs of individual German states (the most important of these is the Prussian State Bank or the Seehandlung); provision of land mortgage and communal credits for which a large number of institutions exist; transactions between the savings banks (Sparkassen), the so-called Girozentralen, etc. This brief survey is only intended to emphasize a factor which is alien to the monetary systems of other states. Progress toward unification is as yet far from being completed.

Savings Banks. Some of these public institutions serve, as previously stated, as a final resort for the savings banks and coöperative credit systems which have reached a very high degree of development in Germany. Concerning the savings institutions whose organization is about the same everywhere, there is little to say. Their number and the size of their deposits played a very important rôle in the German capital market before the war.

The individual savings banks are united in associations which communicate through Girozentralen.

Coöperative Credit Associations. The coöperative credit association is much more typical in Germany. It may be stated here that the majority of the existing Kreditgenossenschaften, about 22,000, belong to one of the three great unions (Verbaende). The purely agricultural associations belong to a central union named after its founder, the General Verband der deutschen Raiffeisen-Genossenschaften. It has a strongly Christian-Socialistic character. Then there is the Deutscher Genossenschaftenverband representing small urban industrialists, and the Reichsverband which is neutral in its make-up. They all rest upon the principle of personal credit confined to narrow local circles. In some instances their ability is unlimited; in other cases there is a limited but joint liability of all the members.

Mortgage Credit Institutions. The important position occupied by German land mortgage credit rests upon centuries-old German legal conceptions. This helps to explain why, notwithstanding the prevailing and overwhelming universality of the German private banking system, this particular branch of credit bank activity is rather sharply separated from other lines. Its historical basis is the German legal conception of pure material liability and in connection therewith came the early establishment of a realty register, entries in which determine the legal status of a mortgage. The business of lending on mortgages is also conducted by private mortgage banks as well as by public institutions. The number of private mortgage banks has never been great. In the years before the war there were somewhat over thirty, with mortgage bond issues outstanding totaling about 11,000,000,000 marks. The savings banks and the insurance companies also figure as lenders against mortgage security without, however, having the privilege of mobilizing their mortgages by the issuance of mortgage bonds.

The Credit Banks. The credit banks, which are discussed more fully in banking literature are all characterized by a certain universality of operations. There is a decided lack of houses of a type that confine their activity to issuing securities, although some of the leading private banking houses, as for example Men-

delssohn and Co., cultivate this branch of activity. The absence of any organization to act as an intermediary between the public and the banks also reflects the existence of an undifferentiated sort of banking mechanism. Brokers as a class are completely unknown. The banks stand in direct relations with the public without intermediaries, and their advice in regard to the administration of property constitutes a not unimportant part of their business activity. Intermediaries whose activity is limited to transactions between the banks themselves (or more exactly bourse traders) are restricted to the Kursmakler, also called agents, among whom a selected group of sworn brokers (vereidigte Makler) have the duty of fixing the official bourse quotations, in this respect closely resembling the English jobber. Since 1900 the concentration movement among the joint stock banks has made such great strides that to-day, besides the seven Berlin Grossbanken, there remain only four larger provincial institutions with a total capital of 101,000,000 marks which have been able to maintain their independence. Among the Grossbanken those with the biggest capitals, whose names begin with the letter D, are known as the D-Banken.

Relation of Grossbanken to German Industry. The relation of the Grossbanken to German industry forms the subject matter of a special chapter. That connection is much closer than in Anglo-Saxon countries or in western states in general. As a consequence of it, Germany was able to effect the industrialization of the country, from 1848 on, solely with the capital supplied by the large private banks. We see, therefore, giant industrial concerns which, through the financing activities of the Grossbanken, have been brought into a certain relationship to the latter. That relationship, however, was by no means so close as in the eastern countries such as Hungary where the personal views of the head of a controlling bank influenced the development of many undertakings. This subject will be further discussed in the section on credit banks.

THE CURRENCY SYSTEM, MONEY MARKETS AND MEDIA OF EXCHANGE

As a general proposition it can be stated that Germany on the one hand still makes great use of the bill (Wechsel) as a circulating medium and on the other hand has brought her clearing methods (Giroverkehr) to a very high state of development. The check, however, a hybrid both in kind and in origin, has not as yet been able to establish itself. The question so long discussed in theory, of check vs. clearing system, has already been settled decisively in favor of the latter. This holds true for money transactions in general. In the small payments of everyday life the modest rôle played by the almost unknown check is even more apparent, and is to be explained by the fact that the postal clearing system modeled on that of Austria, called in Germany Postscheckverkehr, was very successful at the outset.

In the following discussion this fundamental difference between German methods of payment and those of England, for example, will be more closely examined. First of all, small payments in everyday transactions are almost without exception made in cash or by postal transfer. The first method, the most primitive form of payment, still plays so great a rôle, as a matter of fact, that during the war and the inflation years a perpetual shortage of currency in small denominations was the result of the abnormal daily turnover due to many causes. This lack of means of payment resulted in the creation of many unusual types of private emergency issues. That the check should not have been able to establish itself, practically speaking, as a means of payment in daily transactions may be explained in the first place on purely psychological grounds, to which must be added the comparative ignorance of the public in matters relating to monetary transactions. The basis of all check transactions, the possession of a bank account, did not exist before 1900 for the German masses with their low standard of living. In spite of official efforts to popularize the use of the check, for which purpose the stamp tax among other things was removed, success has not been attained to this day. It is evident that inflation was calculated to bury the check system still deeper since, with the value of money steadily depreciating, the recipient

of a check was in a worse position than the person taking cash. Then, besides, there were other deterrents due to the degeneration of public morals and the general poverty accompanying inflation. Finally another circumstance of importance is found in the fact that the spread of banking offices, so far as the German banking system is concerned, has progressed to only a limited degree. The largest German banks at present have branches including deposit offices as follows:

Deutsche Bank	269
Darmstaedter und Nationalbank	209
as compared with	
Midland Bank	1,896
Barclay's Bank	1,850
Crédit Lyonnais	700

The Reichspost. A very good substitute for the check in ordinary transactions is furnished by clearing transfers of the Reichspost. A minimum deposit of 5 R. M. enables a person to open an account into which payments may be made at any post office. In practice, transfers occur in the following way. If both parties have a " Giro " account, the debtor puts his postal check in the nearest letterbox, whereupon, in course of clearing, the sum to be transferred is credited to the payee, with due notice. If only the debtor has an account, the amount is delivered to the beneficiary in cash at his home. In dealings between customers and tradespeople, however, it is most frequently the case that only the latter has a Giro account. Under such circumstances the creditor sends the debtor a card (Zahlkarte) with his address and account number along with the bill, and the customer can make payment in cash at the nearest postoffice to the credit of the Giro account of the tradesman. Even if neither party has an account, the transfer of money probably will not be effected through a bank (the banks try, if possible, to avoid bothering with small sums), but will be paid by a postal money order. So much for everyday methods of payment.

Commercial transactions are carried through in similar fashion. Here also there is excessive reliance upon cash payments, moderate use of checks and very highly developed Giro (clearing) operations.

Clearing Operations of the Reichsbank. By far the most

important factor in interurban clearing operations is the Reichsbank. Through its network of nearly five hundred branches, it is in a position to control the entire clearing transactions of commerce and industry. The Reichsbank clearing system takes care of the larger transactions while the postal clearances provide for the small insignificant transactions. These two clearing systems which serve the public should not be confused with various clearing institutions which meet the needs of a restricted circle, especially the Girozentralen belonging to the public credit institutions. The chief economic differences between the latter and the Reichsbank or Reichspost lie in the fact that they provide a necessary means of communication for a circle of similar institutions. They furnish services comparable to those of the current account of a "Grossbank" in its dealings with its several hundred branches and deposit agencies. Institutions for clearing security transactions have until recently remained very slightly developed. Progress in this field, moreover, such for instance as arrangements for clearing securities, is still far from complete.

Credit Instruments and the Discount Market. Regarding credit instruments, it may be said that since the stabilization of the mark, the bill of exchange, which had almost vanished, has resumed its old position. Bill discounts played a leading rôle in the money market before the war. The frequent attempts of the Reichsbank to secure control over the money market in its contact with the Grossbanken and the discount houses were by no means over at the outbreak of the war, although the Reichsbank could point to some successes. Progressive inflation naturally deprived the Reichsbank discount of its importance. Such paper became more and more of a rarity negotiated at rates infinitely remote from those ruling in the outside market. In November, 1923, a daily market rate of 20 per cent was paid. The period succeeding stabilization was also very unfavorable to the discount market. Open market rates ruled at 20 per cent to 80 per cent as contrasted with a Reichsbank rate of 10 per cent. This was due to the still prevalent distrust of the rentenmark, the dearth of foreign capital, and the well known policy of credit restriction adopted by the Reichsbank after April 7, 1924. It was only toward the end of 1925 and in the course of 1926 that the

outside market for bankers' bills, so important before the war, was reëstablished. Meanwhile, as the market rate approached the bank rate and finally fell below it, the Reichsbank succeeded in regaining its control over the money market to some extent, The movement of the Reichsbank rate and the other market rates since stabilization is shown by the following table.

Average for the year	Bank Rate	Day to Day Money	Monthly Money	Market Rate on Bankers' Bills (From Dec. 1924 only)
1924	10 %	28.23%	25.13%	9.20%
1925	9.16%	9.09%	10.82%	7.62%
1926	7.30%	5.31%	6.57%	5.00%

Among the quotations for which the Berlin Bourse and, to a much less extent, the Frankfort Bourse are authoritative in Germany is the market rate on bankers' bills. This is understood to apply to paper of first-class houses, that is, paper that will be accepted by the Reichsbank for discount. During the period of inflation, a Reichsbank discount provided by far the cheapest source of funds. Hence all first-class bills were rediscounted there. The market rate rapidly lost significance, becoming applicable to ineligible bills alone. Even after the end of the period of most severe capital restriction lasting until August, 1924, the Reichsbank held to the policy of rationing by tacitly following the plan of limiting bills accepted at first hand for discount to an amount equal to the individual capital of those presenting them. Consequently, apart from those periods when the market rate was lower than the Bank rate, many otherwise first-class bills had to be placed in the open market.

Stock Exchange Loans. Market rates on bankers' bills are quoted at short sight (30–55 days) or at long sight (56–90 days). In addition to the bill rate which is used primarily in commercial transactions, there are the daily and monthly money rates growing out of bourse transactions known as "Tagesgeld" and "Monatsgeld." These loans take the form of advances against stock exchange collateral or transfer of checks (Schecktausch). "Day to Day" money which represents a loan that may be called any time is obtained by the smaller firms as a rule against security collateral. It consequently strongly resembles stock

exchange dealings with cash adjustments based on quotations ruling on contango day. Monthly loans are placed usually for one, two or three months, in accordance with international custom. As Germany, in contrast to pre-war times, must depend to a large extent upon short-time foreign loans, rates are quoted for loans in foreign exchange. These are for loans contracted in specified foreign currencies, primarily dollars, then pounds, Dutch gulden, and Swiss francs.

Influence of Public Institutions on Money Market. Besides the Reichsbank reports, which conform to international custom, bi-monthly statements are published by the Grossbanken. These, together with the statements of the mortgage institutions showing the circulation of the mortgage bank bonds, provide a very good index of the activity of the German money market. Quite recently, the Prussian State Bank (Seehandlung) which together with the Reichsbank exercises a great influence over the money market, has made an interesting attempt to counteract the effect of the temporary monetary shortage at the time of the end of the month settlement (ultimo) by paying higher rates of interest on deposits during the critical days. In this way the Seehandlung tries to make itself as strong as possible. Whether its attempt will meet with marked success cannot be said as yet. In any case, the influence of the public institutions upon the money market has increased tremendously in comparison with pre-war days. This is easily explained because, after stabilization, private industry, deprived of all working capital, was only able to restore such capital to a fraction of its pre-war proportions. On the other hand there stand the State institutions which, in preparation for payment of Dawes Plan annuities, are yearly collecting 1,500,000,000 R. M. to 2,500,000,000 R. M. above the sums necessary for the State needs. Another reason for the greater influence of the public institutions lies in their greatly expanded field of social activity (for example, outlays for the unemployed, public building construction, etc.).

In addition to bank notes, hard cash, bills and checks, " Rentenbankscheine " also served as media of exchange for a number of years. Treasury note issues did not at that time exist in any form. The treasury notes issued by the individual states are in large denominations and are not used as a circulating medium.

They belong to the class of gilt-edged securities. Inflationary expedients, such as the private emergency currency and the so-called dollar treasury bills, have already been entirely withdrawn from circulation.

The following excerpt is an illustration of a money market report taken from one of the best known German financial newspapers (the *Frankfurter Zeitung,* September 4, 1927):

"The end of the month caused no disturbance. Only on settlement day did the rate for day money overtake the Lombard rate of the Reichsbank and go beyond it. By September 1 the strain had begun to be felt but it did not continue throughout the week. This relatively slight degree of strain is all the more remarkable because in the last weeks of August alone, interest on industrial and railway bonds together took 180,000,000 marks (following a previous transfer of 90,000,000) which had to be paid into the account of the Agent [3] and thus was withdrawn from circulation and in part from the market. It is true that payments on account of deliveries in kind constituted a certain offset. The fact that in spite of these payments and of other settlement demands, there was no conspicuous tightening of the open market rates, excepting on settlement day itself, is due to the heavy sales of bills. These sales were made in the previous week, especially through bill discounts that almost without exception were taken by the Reichsbank or the Gold Discount Bank. In the current week trade bills have been taken by the Reichsbank, which, according to the end of the month statement, had to acquire not less than 569,000,000 in bills as compared with 223,000,000, 447,000,000 and 547,000,000 at the end of July, June and May respectively. These bill purchases had a double purpose. First the banks wanted to strengthen their position for the day on which the bi-monthly balances were published. The proceeds of the bills permitted them to bring their deposits at the end of the month (settlement day) to the high point of 723,000,000, an advance of 12,000,000 over the preceding week. These cash balances were employed up to the settlement day in the form of day-to-day loans; hence, the liquidity of the market up to and including August 30 and the relatively slight resort to Lombard loans at the Reichsbank. On August 31 they were withdrawn, but on Sep-

[3] Agent General for Reparation Payments.

tember 1 they were again available for the market so far as they were not needed to pay back Lombard loans. The second cause of the bill sales appears to lie in the exchange policy of the Reichsbank. It is well known that the Reichsbank has for months left to the outside market the task of converting into Reichsmarks bills of exchange growing out of foreign credits. The market can not or at any rate is not fully able to function unaided, but obtains the required funds by selling bills to the Reichsbank. That is the unavoidable consequence of every grant of foreign credit which does not take shape immediately in purchases of goods. If the Reichsbank itself were to convert all these foreign credits into marks, the result would be the same degree of market liquidity, based however upon a cover of foreign bills of exchange instead of domestic bills. There is, therefore, only a difference in the security (cover) for the note issue. We regard the exchange conversion policy of the Reichsbank as useful because it shows more plainly than direct conversion would, that the ease in the market is the result of an expansion of credit. Time money remained firm. Monthly money running over the usually troublesome fall term settlement costs 8¼% to 9%. The "swap" rate too (dollar against marks) held at 85 to 90 points per dollar and month, that is about 2½% per year."

LONG-TERM INVESTMENT FINANCING AND THE BOURSE

The development of the German bourse system so far as investment values are concerned began in Frankfort-on-the-Main, the original home of the house of Rothschild. At a period when long-time credits (excepting mortgage or "real" credits) were not to be had by private citizens, this house negotiated loans with individual German states and financed the costs of the Napoleonic Wars for the greater number of the small states. Through the activities of the Rothschilds and a number of smaller houses, Frankfort became the center for this type of investment activity — a special field in which it still competes with Berlin. Long-term private credit was a much later development in Germany and then it took the form chiefly of industrial credit, as

agrarian credit had long been available in the form of mortgage credits. Favored by the remarkable development of German industry, shares acquired incomparably greater importance than industrial bonds. Attention must be called at this point to the fact that one of the principal trading lines in international markets — railway shares and railway bonds — was early lost to the German bourse system (about 1877) as a result of the transfer to government ownership of almost the entire railway system. Public interest was all the more concentrated upon the other share issues whose returns running above 5% were fairly high before the war in consequence of the general prosperity. In order to understand the importance of the share market as compared with the bond market it has to be remembered that the resources placed in savings deposits, communal funds, etc., had reached enormous proportions in relation to the national wealth. A great part of the savings funds that in other countries would have gone into gilt-edged securities found its way through such channels into industry. The relation of capital invested in government loans etc., to that placed in share issues is therefore quite different in Germany from what it is in France. This prewar relationship was subsequently influenced during the war years by one hundred billion marks of war loans. A good part of the sums invested in shares by small holders was exchanged for war loans while the larger investors in shares did not as a rule convert their holdings into the war loan, but usually subscribed their war profits and then based all later loans upon the earlier ones.

Importance of Common Stock. During the war, steps were taken to get possession of security holdings representing investments in neutral countries, while the Peace Treaty forced Germany to give up almost all investments in foreign securities. The subsequent inflation brought with it a multitude of abuses of the small shareholder, involving deprivation of rights and all sorts of reprehensible practices connected with voting shares and treasury shares. The public officials passively permitted these abuses to continue. Now that German industry after stabilization has reached a settled state, a preliminary survey is possible, and it becomes evident that there has been an extraordinary growth of large-scale investment as compared with pre-war times. The predominance of common stock issues (Stammaktien) is characteris-

tic of the German system of share issues. In pre-war days the preferred share was very unusual and generally had only an assured prior claim to dividends or a preferred claim to assets. It was a form of investment intended for the small shareholder. During the years of inflation, the preferred share naturally lost all attraction because of its preferred claim to paper mark dividends. Moreover, the guaranteed repayment of the nominal paper mark value of the share had the reverse of the intended effect. It resulted in placing it at a marked disadvantage as compared with the common stock which represented a substantial equity in the business.

Protection of Voting Rights. The developments of these years led to the appearance of a type of preferred share that carried exclusive voting privileges (Stimmrechtsaktien) in the hands of the majority group. The voting rights carried by a single share rose to many hundreds in some cases. A further abuse grew out of the fact that these "Stimmrechtsaktien" were often not fully paid or the payment required in paper marks was provided by the concern itself in some form or other. As in the case of so many other phenomena of the inflation years, the big shareholder groups were able to invoke the danger of foreign penetration as an excuse for their practices — a danger easily comprehensible to the people. In effect this protection against foreign influence did a good deal more harm to domestic shareholders than to foreign buyers of shares. Measures, such for example as forbidding the sale to foreigners of properties or shares of certain industrial interests of national importance, could hardly have been attempted by Germany during the years when its sovereign powers were invaded by the Peace Treaty. On the other hand, it still remains a mystery why the authorities should have hesitated so long before forbidding grants of credit to foreigners in paper marks, thereby offering direct incentive to foreign speculation.

Shares Without Voting Privileges. A typical financial expedient of the inflation period was the resort to "Genussscheine" which resemble stock dividends and were issued by a good many companies, often as substitutes for paper mark dividends. These "Genussscheine" (stock dividends) as a rule carry the same rights as ordinary stock with the exception of voting privileges. They strongly resemble American shares without

voting power. In addition to the Stimmrechtsaktien, an increasing number of treasury shares (Vorratsaktien) were also created. These were usually common stock issues which, however, were not offered to the shareholders but were kept in the treasury of the company. Later realization on these shares did not always take place in the exclusive interest of the concern itself. Virtually all these practices came to an end with the establishment of gold balance-sheets.

Stable Value Loans. The progress of inflation threw all financial and credit transactions upon the basis of material values. The many facilities for daily payments and the execution of short-time financial operations have been described previously. For long-term transactions there was created an analogous form of stable value loans (Sachwertanleihen) of which the maximum amount outstanding was approximately equivalent to 400,000,000 R.M. classified as follows:

Rye issues	300,000,000
Coal	30,000,000
Sugar	32,000,000
Potash	16,000,000
Lumber, wood	8,000,000
Total	386,000,000

Financing Since the Stabilization of the Mark. Stabilization of the currency, regulation of the budget, and the establishment of an industrial program through the Dawes Plan provided the bases for resumption of long-time loans. At first, however, the domestic market was entirely unable to furnish funds of any sort beyond day-to-day requirements and, consequently, there inevitably followed a period of exclusive reliance upon foreign loans. While short-term credits seeking higher interest rates were drawn from all quarters, especially neighboring countries, America played by far the most important part in the field of long-dated loans, with Holland a remote second. Since stabilization the value of the foreign loans negotiated stands as follows:

Year	Amount in Reichsmarks (round numbers)	
1924	1,000,000,000	(including Dawes loan)
1925	1,200,000,000	
1926	1,900,000,000	
1927	900,000,000	(to Sept. 15)
Total	5,000,000,000	of which about 70% was placed in America.

INVESTMENT PRACTICES ADAPTED TO AMERICAN TASTES. Because America has been the most important source of funds for Germany, the German loan system has come to adapt itself to American conditions. Hitherto the only adaptable form of security was the already described preference share, while common stock issues and industrial bonds, precisely defined by law as owner and creditor claims respectively, had no relation to each other. Convertible bonds were unknown to German company law. In order to make security issues attractive to foreigners the latter type was introduced, likewise bonds carrying stock purchase warrants. A number of loans of both types met with a good reception, for instance the bonds with purchase warrants attached issued by the Stahlverein. A form comparatively little used was represented by those bonds which participated in the profits of the company through supplementary dividends. The Siemens-Schuckert dollar loan may be mentioned as an example of this type.

RENAISSANCE OF DOMESTIC INVESTMENT MARKET. Alongside the foreign loans, the domestic market, which had hitherto been limited to stable value loans (Sachwertanleihen), began to show ability to absorb offerings. The Reichsbank directed every effort toward this reawakening. In order to apportion the proceeds of foreign loans with some regard to currency and reparation requirements, an advisory board (Beratungsstelle) was created in connection with the Finance Ministry with supervision over the loans of public corporations. The first internal loans were issued entirely upon a fine gold basis and usually carried interest at 10%. Further developments were influenced by the inflow of foreign capital and the creation of domestic capital which has caused a progressive lowering of the internal interest rate. This process led in September, 1926, to a reduction of the Reichsbank discount to 5%. After the entirely successful issue of 100,000,000 R.M. of 7% preference shares of the German Railway Company at 95, issues of leading industrial concerns began to appear in the fall of 1926 for foreign and domestic sale. These also met with success. A much less favorable reception was accorded the notes issued by the Reichspost at the end of 1926, to the amount of 130,000,000 R.M. This development came to an end in March, 1927, with the offering of 500,000,000 R.M. in the form of a 5% loan of the Reich at 92. The strength of the market had been overestimated

and the loan was a failure. Since that time, leaving out of account the seasonal fluctuations of money, a marked firmness in interest rates has been perceptible. This has found reflection, since April, 1927, in the almost complete cessation of sales of bonds by mortgage banks and a recession in the values of all fixed interest securities. Although the mortgage banks had come to consider the 8% type of gold mortgage bond as a thing of the past, and had gone over to the 7% type, 8% mortgage bonds are today (October, 1827,) again obtainable at par. The movement of investment values is shown by the table given below:

Average Annual Quotations of German Gold Mortgage Bonds (Pfandbriefe) 1924–26

	7%	8%	10%
1924	72.6	85.7	88.8
1925	81.2	84.6	93.6
1926	94.8	99.1	105.23

The German Share Market. The German share market did not follow the trend of the investment market which reflected German monetary conditions fairly accurately. The share market was aroused violently from the lethargy which prevailed until the beginning of 1926 by such catchwords as "rationalisation," "concentration" and much advertised new processes such as the liquefaction of coal, etc. The uninterrupted advance which followed was maintained until Black Friday, May 13, well known in the annals of the Bourse. A recession of panic proportions, caused by the interference of the Reichsbank, followed until today (October, 1927,) a period of greater fluctuations has set in with the average return of the quoted shares of German corporations yielding about 5.3%.

The table shown at top of next page presents a survey of the invested capital before and since the war represented in bourse trading.

Peculiarities of the German Bourse System. As a purely technical matter the percentual quotations which exist on all German Bourses should be mentioned. This method of quoting applies not only to bonds but with few exceptions to all shares. Under present conditions in Germany, it is the only practicable procedure because, as a result of the capital conversions necessi-

OFFICIALLY QUOTED DOMESTIC SECURITIES

	Dec. 31, 1912 (according to Richard Calwer)	June 30, 1927 (estimate)
	(Nominal value in billions)	
	Marks	Reichsmarks
State and Communal Loans	31.2	1.8
Mortgage Bonds and Communal Bonds	8.3	2.5
Railway and Industrial Bonds	2.9	0.8
Total of Fixed Value Securities	42.4	5.1 or 12%
Shares	9.5	11.0 or 115%

tated by gold balance-sheets, the nominal values of individual shares are quite differently computed and it will be some time before uniform practices can be expected to develop. Details in regard to this subject will be found in the section on gold balance-sheets. Incidentally prior to the war the high nominal value of shares was almost always fixed at 1,000 marks (about $240.00) for which reason the savings of the small investor went into savings banks and similar institutions, not into investment securities.

Exceptions from the practice of quoting in percentages are found in case of shares of the insurance companies (because often not fully paid) as well as colonial and other foreign securities. Through lack of special sales organizations, bond salesmen, etc., the German system of placing loans is characterized by great cheapness.

Protection of the Public. The ruling conceptions of the functions of the State have resulted in far-reaching methods for the protection of the public. Only a few especially important features can be selected for discussion. In the years after 1890, which were characterized by active speculation, it was discovered that frequently the deposits of customers had been pledged to obtain cash. This and other defects led to the passage of the " Depotgesetz " of 1896 which was intended to correct the existing inadequacies. It had not, for instance, been made sufficiently clear in what month the customer acquired property rights in the paper purchased for him on commission (in case of bankruptcy he had the right of withdrawal). Further misunder-

standings had grown out of the fact that provincial bankers had deposited share holdings quoted on the larger Bourses, with banks located in such centers, neglecting to indicate whether the securities in question belonged to them or were being held for the account of others. The Depotgesetz (trust deposit law) requires that the banker shall keep segregated the securities acquired for the account of a customer and carry them separately in his "Depot book," by entry in which the customer acquires his property rights. Furthermore, the banker is expected to send the customer within three days a list of numbers of the securities purchased for him. This notification may be dispensed with only in transactions between banks. In the case of individual customers, such waiver requires each time a specific statement in writing. Similarly, the provincial banker, when giving an order to the banker resident at a bourse center, had to state whether this order was for himself or for account of a customer. In practice, the provisions of this law were not observed. The first requirement was as a rule evaded by the banker's not placing the securities bought for the customer to the latter's account (Depot) but crediting them to special deposit account (Stueckekonto). In this way, instead of acquiring a property right, the customer obtained only a claim which in case of bankruptcy had to take its chances with all the other liabilities incurred by the banker.[4]

Nevertheless, the customer has the right to demand a transfer without delay at any time to his deposit account. In dealings with the provincial bankers, an association formed by the most important Berlin banks, known as the Stempelvereinigung, decided as early as 1896 to carry in future two separate accounts, *A* and *B*. *A* was for securities which belong to the provincial banker himself, and which the Berlin bank could hold as security for claims against the provincial bank. Depot *B*, on the other hand, comprised all the holdings which the provincial banker had expressly designated as not belonging to him. In case of the

[4] Through an amendment of June, 1924, this proceeding, already developed in practice, has been recognized by the law to the extent that to-day in cases of commission business — when no other instructions are given — the banker is always entitled to credit the securities belonging to the customer on Stock Account. Almost without exception this method is employed and it is a prerequisite for the development of clearing operations in securities.

latter, a bank naturally had no right of retention except in the event of claims arising from the purchase of such securities.

Important provisions for the holder of marketable securities (with the exception of public issues) are contained in the law concerning the joint rights of the holders of "Teilschuldverschreibungen" (obligations or debentures) of which the details will be given in connection with the section on mortgage banks. There are innumerable regulations relating to State supervision and publicity requirements for financial institutions. The provisions in regard to mortgage banks are the most far-reaching. Regarding the duty of publicity, it is obligatory that every German joint stock company shall publish its yearly balance-sheet in the Reichsanzeiger. Corporations whose shares are quoted on the Bourse must also publish their statements in a daily newspaper. One deplorable lack in German accounting practices is that chartered accountants are not employed to anything like the same extent as in America and England. The German law provides innumerable protective measures for small shareholders which have recently been supplemented by the protective regulations relating to gold balance-sheets.

THE REICHSBANK

The Reichsbank is an independent institution created by the bank law of June 30, 1924, whose function it is to supervise the German monetary system, regulate the circulation of money within German territory, facilitate payments and place surplus funds at the disposal of industry. It is also legally empowered to issue bank notes expressed in terms of reichsmarks.

The bank has an authorized capital of 300,000,000 R.M. of which 122,788,000 R.M. is now outstanding. There are also various reserve funds having a total value of not less than 214,000,000 R.M. The shares of the Reichsbank are privately held and in this respect and particularly as regards its complete independence of the State the Reichsbank resembles a private institution. In respect to the public functions transferred to it by law, the bank has however the character of a public institution; its employees are officials with the privileges and duties pertaining

to their status. This hybrid position is best comprehended by saying that in relation to the State the Reichsbank is a purely private institution, but in its dealings with the public it has an official status.

Origins of the Reichsbank. The history of the Reichsbank goes back to 1765 when Frederick the Great founded the Koenigliche Bank in Berlin as a purely state institution which was in turn converted into the Preussische Bank in 1846. At that time the character of the institution was modified to the extent that a central committee of private shareholders was formed whose rights however were comparatively unimportant. In the year 1875, by an imperial law of March 14, the Preussische Bank was transformed into the Reichsbank. The bank continued to be subject to the supervision and guidance of Reich officials.

Former Management Control of Reichsbank. The supervisory powers of the Reich were exercised by a Board appointed by the Emperor and the Federal Council (Bundesrat) whose chairman ex-officio was the Imperial Chancellor. The general management of the Reichsbank was entrusted to the Chancellor to whom the board of directors of the Reichsbank was subordinate. The members of the board of directors were appointed by the Emperor upon the recommendation of the Federal Council. The position previously occupied by private shareholders remained unchanged. Their rights were de facto of a purely formal nature. The General Assembly which met once a year and the central committee (Centralausschuss) had mainly advisory powers. For example, the Centralausschuss could designate three representatives to attend the meetings of the Reichsbank board of directors (Direktorium). They had, however, no voice in the conduct of affairs.

The character of the German Reichsbank at the time was well suited to the national temper and was adapted to the favorable conditions that prevailed prior to the war. It should not be forgotten that originally in all European monarchies the rulers regarded the right of issuing notes as a continuation of the sovereign right to mint coins which had been theirs from time immemorial. Even the Bank of England owes its independent organization, which it won a century and a half before the Reichsbank, to

monetary dependence of the sovereign upon domestic financiers. The structure of the Reichsbank remained unchanged during the entire pre-war period.

THE NOTE ISSUE PRIVILEGE. At the time of its establishment (1875) the German bank note system was in a deplorable state. Thirty-three banks of issue were in existence, owing their privileges to the previously prevailing particularistic spirit, and in part to certain very unfortunate financial manœuvers. The laws establishing these banks show many fundamental differences in respect to the note contingents, the provisions for cover, etc. The bank law of 1875 represents a compromise between centralizing and federalistic tendencies since it provided for a central bank system which, nevertheless, permitted the existing central banks to continue to function under extensive regulations. A fixed system of contingents for note issues was adopted for the private note-issuing banks while the Reichsbank (in marked contrast to the Bank of England) was provided with a fundamentally elastic system of note issue with indirect restriction through a 5% note tax.

PRIVATE NOTE-ISSUING BANKS. As a result of the bank law, 20 out of the previously mentioned 33 note banks had relinquished their concessions by 1899; their note contingents were consequently transferred to the Reichsbank. By 1906 there remained only four private note-issuing banks which are still located in the four largest states of the Reich, namely, the Bayerische Notenbank, the Wuerttembergische Notenbank, the Saechsische Bank, and the Badische Bank.

CAPITAL AND RESERVES. In 1899 the capital of the Reichsbank, which previously stood at 120,000,000 marks, was raised to 180,000,000 marks, and the reserve was increased from 30,000,000 marks to 60,000,000 marks.

RECHARTERING OF THE REICHSBANK. The Reichsbank charter ran for ten years and was renewable thereafter for another period of ten years. The approach of this renewal was the signal for a thoroughgoing examination of its previous activity and the recharter was accompanied by a number of amendments in the law. As the period after 1875 did not subject the bank management to any extraordinary difficulties, there was hardly oppor-

tunity to raise a question of the efficiency of this state system of organization. The individual changes as a rule applied to unimportant formalities. Not until 1909 were the notes of the Reichsbank declared to be legal tender. In 1910, in order to relieve the extraordinary needs for money at the end of the quarter, the tax free note contingent was raised from 550,000,000 marks to 750,000,000 marks. In each successive year lengthy negotiations took place between the Reichsbank and the Grossbanken, which had grown over-powerful, with a view to inducing the latter to maintain certain minimum balances with the Reichsbank, to increase their own cash holdings, and to prepare bi-monthly statements. These efforts were completed prior to 1912. With the beginning of the war a number of laws were at once passed which provided for removal of the tax on note issues, removal of the obligation to redeem notes in gold, creation of the Darlehenskasse (which issued Darlehenskassenscheine) and admission of treasury notes as cover for bank notes.[5]

The Reichsbank and the Republic. The Republic took over the imperial Reichsbank entirely unaltered. It was not until 1922 that a fundamental change in the constitution was made by which the chief control passed from the Imperial Chancellor to the Reichsbank board of directors. In this way the Reichsbank became formally much more independent. Personal considerations inherent in the management and the desperate condition of the country, however, prevented attainment of any practical results. Although the Reichsbank took an energetic attitude toward the administration in domestic affairs, the needs of the State continued to be covered by issuing bank notes. Objectively viewed, the Reichsbank is less to be criticized for lack of energy in its dealings with the State than for a certain yielding attitude toward private demands. It must be kept clearly in mind, however, that the weapon of discount policy, which is the peculiar possession of a bank of issue, had become completely ineffective through the progressive advance of interest rates. For that reason it was all the more necessary for the bank to proceed against the nuisance of private emergency money, and to support its discount policy

[5] For a discussion of the Reichsbank during the war years, when it undertook to float nine large German war loans as well as to control exchange operations from the year 1916, see the historical introduction.

through quantitative control of the volume of credit. The printing of private notes had indeed been indirectly encouraged by the fact that, for reasons of prestige, the bank only put larger denominations into circulation after interminable hesitation and generally did not put out a larger unit until the latter had already been deprived of much of its purchasing power. For example, in the summer of 1922 with a quotation of approximately 2,000 M. for a dollar, the largest bank note in circulation was of the denomination of 1,000 M. Thus, an industrial country, unusually dependent upon cash payments as Germany is, had to manage with a unit equivalent to fifty cents.

Exchange Intervention by the Reichsbank. The more or less passive rôle which the Reichsbank played during the entire inflation period was reflected in the fact that its various efforts at intervention to support the mark originated not so much from within as from without, upon the insistence of the Government. These attempts at intervention consequently always coincided with a particularly unfavorable political situation, instead of being timed to encounter favorable political and economic conditions. The first important attempt at intervention by the Reichsbank came in the summer of 1922; the second followed, as already mentioned, immediately upon the occupation of the Ruhr (February, 1923). At first this intervention had fairly great success, only to lead in the end to one of the greatest and most unfortunate disasters. After the Reichsbank had succeeded in putting a check to speculation, it held the dollar for weeks at an artificial level of 21,000 M. During this period of the most serious Ruhr struggle, some industrialists of the occupied territory as a later investigation revealed, ruthlessly employed the funds which for political reasons had been placed at their disposal by the Reich in excessive amounts to buy up exchange thrown on the market. As the Reichsbank had reached the end of its resources, the collapse that followed was so much the more serious. The dollar rose from 21,000 M. on April 17 to 1,100,000 M. at the end of July. The Reichsbank made a final effort to support the exchange during July of this same year but with hardly a momentary success.

In the short interregnum between the old Reichsbank, whose

notes vanished in November, 1923, and the present Reichsbank, the German Rentenbank came into existence.[6]

New Reichsbank Law. Out of the negotiations between the expert committee appointed by the Reparation Commission and the German Currency Commissioner, Dr. Schacht, grew the principal changes which distinguish the new bank law that went into effect on August 30, 1924, from the old law of 1875 which forms its basis.

Present Management of the Reichsbank. In accordance with this law, the influence of the government upon the choice of the Reichsbank president is limited. If the government should refuse confirmation to three successive presidential nominees proposed by the Reichsbank board of directors, its right of confirmation thereafter becomes inoperative.

Administrative functions aside from executive duties are divided among three bodies: the General Assembly of shareholders, the Central Committee and the General Council (Generalrat).

Attendance upon the General Assembly is open to every shareholder registered upon the books of the Reichsbank. Each share is entitled to a vote, with a maximum of 300 votes per person. In contrast to the old Reichsbank the rights of the General Assembly correspond to those of a private corporation. Among other privileges the General Assembly selects the Central Committee (Centralausschuss).

The Central Committee is in fact elected from among the members of the General Assembly upon advice of the directors. It is composed of 21 members who represent various professions. Its rights otherwise are not very different from those formerly exercised. The arrangement for selecting non-voting deputies to attend directors' meetings remained unchanged.

The General Council (Generalrat), established as the most important organ of the new Reichsbank, consists of 14 members, of whom seven are Germans and seven foreigners, with the Reichsbank president as chairman. He is included in the number of German members and in case of a tie his vote is decisive. The members of the General Council were at first appointed by the organization committee created by the experts' committee. Upon expiration of the three years' term of office, memberships are filled

[6] Particulars regarding it are given on page 000.

by coöptation. Among the foreign members there must be one British, one Italian, one French, one American, one Dutch, and one Swiss citizen. In selecting a new foreign member, the central bank of issue of the country from which he comes is to be consulted. No person having a position under the Reich or the States or receiving pay from the Reich or an individual State may be included in the General Council. The same restrictions apply to foreign members. From among the latter, the Council selects a commissioner of note issues.

Business of the Reichsbank. The executive of the Reichsbank consists of the board of directors (Direktorium) including the president, one vice-president and seven other members. Under their management there are, in addition to the central office in Berlin, 17 main offices, in the leading cities of Germany, 84 branches, 344 subordinate branches, 8 agencies and a goods depot. The business of the Bank covers the following lines of activity:

(1) Buying and selling gold and silver bullion coins.

(2) Discounting bills of not more than 3 months' currency, carrying three responsible indorsements. The third indorsement may be dispensed with in case there is collateral security or some other way of guaranteeing the security of the bill or check. The amount of bills not bearing a third indorsement may not exceed 33% of the total volume of discounted bills. Bills discounted by the Bank must be good trade bills (Handelswechsel)

 (a) Buying and selling treasury bills issued by the Reich which fall due within three months at the latest, and for which in addition to the Reich another responsible party is liable. The total volume of treasury bills discounted or purchased in accordance with this provision, or in conformity with 3g (see below) may not exceed 400,000,000 R.M. The amount must be shown in the weekly statements and such discounts may not serve as cover for notes under the definition of section 28.

(3) Granting interest-bearing loans for not longer than three months against transferable securities. (Lombardverkehr)

 (a) Against gold or silver in the form of coin or bullion.

(b) Against fully paid stock and preference shares, likewise against prior obligations of operating German railways, also against mortgage bonds issued by German agricultural, communal or other types of land-credit-institutions operating under State supervision. Loans against such mortgage bonds may be made in amounts not to exceed three-fourths of their current value. Bonds payable to bearer issued against loans granted to domestic communal corporations, or against guarantees assumed by such corporations have the status of mortgage bonds (Pfandbriefe).

(c) Against obligations payable to bearer falling due within one year, issued by the Reich, a German State or a domestic communal corporation, or against interest-bearing obligations whose interest payments are guaranteed by the Reich or by a State. Loans can only be made to three-fourths of the current value of these securities. Such loans can only be given to banks known to be solvent.

(d) Against interest-bearing obligations payable to bearer, issued by non-German states and against State-guaranteed foreign railway obligations having a preferred status. Loans may be made up to fifty per cent of the current value of such securities.

(e) Against bills representing the obligations of recognized responsible parties, with a deduction of at least five per cent of the current value.

(f) Against the pledge of warehoused commodities within the country to a maximum sum equal to two-thirds of their value.

(g) Against treasury issues (within the limits mentioned under sub-section 2) which have not over three months to run, with a deduction of 5 per cent from current value.

With the special permission of the General Council the bank may take as security for a loan the long-term bonds of the Reich, of maximum 3 months' currency provided that in addition to this collateral security, there are two other indorsers, one of

whom must be a banking firm doing business in Germany. It is further provided that the amount of loans for which long-term bonds are used as collateral shall never exceed the amount of the paid-up capital and reserve funds of the bank.

(4) Buying and selling obligations of the sort described under 3c. The purchase of such obligations by the bank for its own account is only permitted to the extent necessary to take care of current business of customers.

(5) Collection of money for account of private persons, institutions and public bodies and making payments, assignments or transfers to branches or correspondents.

(6) Purchasing and selling for third account securities of all sorts and precious metals, previous cover or prior delivery, respectively, having been arranged for.

(7) Receiving non-interest bearing funds in connection with deposit business and clearing operations.

(8) Safe-keeping and management of articles of value.

The Issuance of Bank Notes. The right of note issue has been granted to the Reichsbank for a period of fifty years. Bank notes are issued in terms of reichsmarks and are legal tender. The function of note issue is under the control of a foreign member of the Council (Generalrat). The total volume of the circulation is not, as previously mentioned, limited, that is, there is no fixed contingent. Notes in circulation must be covered to at least forty per cent by gold and foreign bills of exchange (at least three-fourths of this 40% must be in actual gold. The rest of the cover consists of commercial bills and checks which must conform to the provisions mentioned on page 667. The Bank is bound to redeem bank notes upon demand either in German gold coins, gold bars (not less than the value of 1,000 R.M.) or in foreign bills of exchange at the rate of the day. The bank is forced to publish each week the relation between the note cover and the notes in circulation.

Distribution of Profits. Twenty per cent of the net profits are yearly to be transferred to a reserve fund so long as the latter is less than 12% of the note circulation of the bank, reckoned on the basis of the average of the preceding six months. The share-

holders are entitled to a yearly dividend of 8%. If this dividend is not earned, the deficit is to be taken from the net earnings of the succeeding years, after transfer to the reserve fund of the legally required sums has been provided for. The dividends may, of course, be paid out of an established dividend reserve fund. After subtraction of these dividends, the remainder of the net earnings is divided as follows: From the first 50,000,000 R.M. the Reich receives one half, the shareholders, the other half. Of the next 50,000,000 R.M. the Reich receives three-fourths and the shareholders, one-fourth. Of the remainder, the Reich receives nine-tenths and the shareholders, one-tenth. The amounts going to the shareholders may be paid out either in the form of additional dividends or else be transferred to a special reserve fund for future dividend payments as a means of maintaining stability in dividend policy.

PUBLIC CREDIT INSTITUTIONS

(Die Oeffentlich-rechtlichen Kreditinstitute)

One of the most interesting chapters of German monetary history relates to the public credit institutions briefly mentioned in the introduction to this study. A systematic survey will be attempted in the course of the following discussion.

1. The Gold Discount Bank. There is a group of institutions which should be examined in immediate connection with the Reichsbank with which they stand in close organic relationship. The German Gold Discount Bank was founded by the law of March 19, 1924, at a time of acute credit shortage. German industry was threatened with collapse from lack of working capital, abstention of foreign lenders following mark stabilization, and finally from the unavoidable but Draconian severity of the Reichsbank credit restrictions.

In the face of these material deprivations a more formal difficulty arose. The recently created rentenmark which until August, 1924 (date of new Reichsbank law) provided the only support of the German monetary system, was an exclusively internal currency. Considering its character, which closely resembled the assignats of the French Revolution, it could not

possibly take rank in world markets with foreign currencies based upon gold. German export business felt all the more keenly the lack of a supporting financial institution. The German Gold Discount Bank was therefore intended to serve as a central bank for foreign transactions to supplement the Rentenbank which was limited to domestic payment transactions. In the law establishing it (March 19, 1924) the Bank was therefore given the right to issue notes in English pounds which, however, were to circulate only outside the country. The note cover was to consist to the extent of 50% of gold and foreign gold currencies — the remaining half was to be represented by bills and checks drawn in foreign currency (in practice only dollars and pounds were acceptable). The note contingent was limited to £5,000,000, a fixed contingent in contrast to the Reichsbank system. This shows clearly that the German Gold Discount Bank was conceived to be a provisional institution having a specialized field of activity. As the establishment of the new German Reichsbank followed in very short order, the activity of the Gold Discount Bank in the form originally intended was confined to the time between March and August, 1924. In consequence of the shortness of this period, no pound notes were issued, as the Bank was able to perform its functions as a foreign bank of discount without resort to note issue.

The capital of the Gold Discount Bank was fixed at £10,000,000 divided into two equal series (A and B). Group A, in the form of fully paid shares, was taken over by the Reichsbank, while the second series was acquired by a consortium consisting of all the leading banks upon a payment of 25%. The successful reorganization of the German currency system which followed shortly (Dawes Loan) induced the Reichsbank at the beginning of 1925 to acquire from the private banks their holdings of shares of the Gold Discount Bank through exchange for Reichsbank shares, so that the institution is now entirely owned by the Reichsbank. From this time forth, therefore, the Gold Discount Bank forms an integral part of the Reichsbank whose flexibility has been decidedly increased as a result. The management of the Gold Discount Bank consists of the President of the Reichsbank and certain members of the Reichsbank board of directors. The supervisory council of 24 members originally provided

for is made up solely of members of the Reichsbank board of directors.

Functions of Gold Discount Bank. The discount of export bills was originally the primary purpose of the Gold Discount Bank. This essential aim was weakened, as already mentioned, as the German monetary system became progressively stronger. A characteristic step forward was made on April 1, 1927 from which date export bills eligible for discount might be drawn in reichsmarks, whereas hitherto only dollars and pounds had been accepted. The released resources of the Bank were now placed at the service of the agricultural credit policy of the government, while the bank entered into a closer working relation with the Rentenbank-Kredit-Anstalt assuming the obligation to take over from the latter, mortgage securities to the amount of 250,000,000 R.M.

In addition to export bills, acquisition of bankers' bills in the Berlin money market provided a means of investing funds not required for the two chief purposes already mentioned.

ii. The Rentenbank and Rentenbank-Kredit-Anstalt. The already mentioned coöperation with the German Rentenbank-Kredit-Anstalt represents the latest developmental phase of the Gold Discount Bank — a development still in its first stages.

The German Rentenbank-Kredit-Anstalt, established by a law of July, 1926, is the successor of the German Rentenbank. The Rentenbank (which must not be confused with the purely local land mortgage credit institutions of the like name) has now a Janus face. On the one hand it is the agency that issued the German rentenmark, which during the brief transition period in 1923 constituted the representative domestic currency. In this capacity the Rentenbank has no further tasks beyond liquidation of its obligations. On the other hand it provided the foundation for the Rentenbank-Kredit-Anstalt.

Withdrawal of Rentenbank Notes. The most important features of the rentenmark issues have already been noted. In conformity with the methods by which the rentenmark was put into circulation, its withdrawal is now being comsummated. As stated, the basic capital and the reserves of the Rentenbank to the amount of 3,200,000,000 rentenmarks were provided by placing a land mortgage of like amount upon all business (agriculture, in-

dustry and trade). It was intended to mobilize these mortgage debts by the methods normally followed in issuing mortgage bonds, through converting them into interest-bearing "Rentenbriefe." The latter were to serve as cover for the rentenmark, then in general circulation. Since the transition to the gold standard took place in Germany with unexpected rapidity, the issue of Rentenbriefe, like that of pound notes by the Gold Discount Bank, was from the start recognized as superfluous. While, as already stated, no pound notes were ever issued, a minimum quantity of the contemplated Rentenbriefe was issued (less than 200,000 marks), which meanwhile have vanished. On the other hand, the issue of Rentenbank notes naturally was carried through in full measure. It required the utmost energy on the part of the Rentenbank management and the responsible Currency Commissioner, Dr. Schacht, to resist the demands of private industry and the State, both destitute of cash. All told, in accordance with a prearranged program, a total of 1,200,000,000 rentenmarks was placed at the disposal of the State and a like amount granted to private industry. When in August, 1924 the new Reichsbank began to function and the Rentenbank consequently could consider its task fulfilled, the question arose how to gather in the rentenmark credits from the State and from private borrowers, and to withdraw the Rentenbank notes. In the case of those credits granted to industry and trade, retirement was only a question of time, but it was evidently quite impossible to collect within a short period the credits of about 800,000,000 rentenmarks granted to agriculture. Speedy repayment of the credit given to the Reich was from the start not contemplated.

Liquidation of Rentenmark Credits. The liquidation of the credits granted will now be described. It must be remembered that every reduction of the volume of credit meant a like reduction in the note circulation, as the Rentenbank, after the reëstablishment of the Reichsbank, was not permitted under any circumstance to do business that would lead to an issue of rentenmarks. The liquidation of the Rentenbank stands in close causal relation to the Dawes Plan. As yearly payments under the Dawes Plan rest in part upon industry, the mortgages placed upon industry and trade for the security of the rentenmark were lifted with a simultaneous addition of 25% to the burden borne by agri-

culture. At the same time the law regulating the liquidation of the Rentenbank required a reduction of the capital to 2,000,000,000 rentenmarks — a sum corresponding to the rentenmark credits given to the Reich (1,200,000,000) and to agriculture (800,000,000). Consequently there was withdrawn 800,000,000 rentenmarks corresponding to the capital and reserve account made superfluous by liquidation. An additional 400,000,000 rentenmarks representing trade and commercial bills was taken over by the Reichsbank for liquidation. For the repayment of the rentenmark loan granted to the State the following resources were made available.

(1) The interest on the mortgage debt at the rate of 5% (resting now entirely upon agriculture) which was reckoned at 100,000,000 R.M. (5% of 2,000,000,000) for whose payment the Reich guaranteed at least 60,000,000 rentenmarks yearly.
(2) A yearly contribution of the Reich to the amount of 60,000,000 R.M.
(3) The share of the Reich in the net profits of the Reichsbank.

The Rentenbank-Kredit-Anstalt. For the liquidation of the rentenmark credits given to agriculture, the German Rentenbank was transformed into the German Rentenbank-Kredit-Anstalt — the other side of the Janus face of the Rentenbank turned toward the future. The latter, which had to complete the liquidation of the rentenmark currency, received the right to participate in the ownership of the share capital of the German Rentenbank-Kredit-Anstalt to the extent of 25,000,000 rentenmarks. Moreover, the Bank was empowered to transfer available resources from time to time to the Rentenbank-Kredit-Anstalt as was the case with the Gold Discount Bank.

The German Rentenbank-Kredit-Anstalt was founded to create and grant credits to agriculture as an institution public in character, subject to the supervision of the government. The reason for establishing it was the so frequently mentioned credit distress of German agriculture and the impossibility of withdrawing the 800,000,000 rentenmarks already advanced to agriculturists. Moreover, it was the wish of the administration in connection with

the import of foreign capital to create a central agency for German agricultural credit (real and personal) and thereby avoid the indiscriminate introduction of foreign credits which had greatly increased the cost of borrowing.

ADMINISTRATIVE CONTROL OF RENTENBANK-KREDIT-ANSTALT. The original capital of the German Rentenbank-Kredit-Anstalt was not as in the case of the Reichsbank provided by individual shareholders or corporations. It represents on the contrary a sum allotted to the institution by law. In the event of dissolution the general meeting with the approval of the government may dispose of the assets as it chooses but with the proviso that they must be exclusively used for purposes of agricultural credit. The chief administrative organ is the Board which consists of 110 members, who represent the most important agricultural organizations and coöperatives. In addition there is an administrative council about half of whose member's belong to the Board, while half are members of parliament. The president of the German Rentenbank, now in process of liquidation, is chairman. The executive body is represented by the customary managing committee of at least two members.

FUNCTIONS. The functions of the institution embrace the following main activities:

(1) Distribution of credits to a circle of land mortgage credit institutions specifically designated in the law.
(2) Credit grants to institutions similarly designated, engaged in furnishing personal credits to agriculture.
(3) Credit grants to corporations under government control for purposes of furthering the cultivation of the soil and agricultural settlement.

The circle of institutions involved in these three types of activity contemplated by the law are naturally themselves public credit institutions. In the following discussion of the several types, reference will again be made to this point. A direct grant of credit to agriculture is absolutely forbidden; the institution has therefore the character of a central credit organization as indicated by its sub-title (Agricultural Central Bank). The means necessary to provide the credit advances are provided from

(1) Funds obtained from the Rentenbank.
(2) Large foreign loan issues (up to now).
(3) Mortgage bonds of which about 270,000,000 R.M. had been issued to the end of 1926.

For the most part these issues were placed with State institutions. The most important arrangement was made with the German Gold Discount Bank which took over mortgage bonds to the amount of 250,000,000 R.M.

III. Private Banks of Issue. As a final type of institutions belonging to the circle of the Reichsbank, the private note-issuing banks should be mentioned. As set forth in another place, the old Reichsbank law of 1875 constituted a well-weighed compromise between the centralizing tendencies represented by the Reichsbank and federalistic ideas. While the majority of the private banks of issue (so-called Zettelbanken) relinquished their note issue privileges in the decades which followed, there still remain four note-issuing banks located in the four greatest non-Prussian states (Bavaria, Wuerttemberg, Saxony and Baden). These latter are known as private banks of issue in order to distinguish them from the Reichsbank. By contrast with the Reichsbank they are subjected to a number of restrictive provisions as regards the privilege of note issue. Their notes are not legal tender. The amount of their issues are limited and are fixed as follows by the law of August 30, 1924: Bayerische Notenbank, 70,000,000 R.M.; Saechsische Bank, 70,000,000 R.M.; Badische Bank, 27,000,000 R.M.; Wuerttembergische Notenbank, 25,714,285 R.M. Dr. Schacht says that in " the course of the discussion of the new Reichsbank law it almost came to a tacit elimination of the four private banks of issue still existing in Germany. The foreign experts were obviously ignorant of their existence. Although as President of the Reichsbank, and for reasons of general economic policy, I could not take a very favorable attitude toward the perpetuation of the privilege of private note issue, nevertheless I thought it proper for domestic political reasons to call the attention of the experts to the existence of the private note issue banks and to emphasize the internal political reasons which made it highly desirable to continue them within the limits set by the German law regarding banks

of issue. A recommendation to that effect accordingly found acceptance." [7]

The present significance of these four private note banks is fully summarized in these few words. From the purely technical standpoint of the money market they exert the same influence as would the presence of four additional important branches of the Reichsbank. From the historical point of view, as already indicated, they are only relics, not to be confused with the State banks of the several federal states.

SUMMARY. The circle of these institutions standing in close relation to the Reichsbank may be studied from a number of points of view as for example:

(1) Services rendered in the reconstruction of German industrial life after the years of inflation. One result of this has been that measures and institutions have often had a provisional character. (The most important instance is that of the German Rentenbank).
(2) Provision of credits with especial regard for the needs of German agriculture. Since the Reichsbank, by virtue of its character, was entirely unable to grant the sort of long-term credits that agriculture requires, the Kredit-Anstalt was founded as the centralizing agency for agrarian credit. The Rentenbank in process of liquidation, and also the Gold Discount Bank, coöperate with it. The original purpose of the Gold Discount Bank was rendered largely illusory by the appearance of an international Reichsbank in place of a domestic Rentenbank. A foreign loan policy following certain general principles made it possible gradually to improve conditions as is evidenced by the various successful issues.
(3) Control over the German money market.[8]

IV. THE STATE BANKS. The State banks are institutions which under the guaranty and supervision of the individual States are entrusted with certain duties in accordance with general economic principles. Their circle of activity is, however, confined to the territory of those States which are responsible for them. Due to the

[7] Quoted from Dr. Schacht's "Stabilisierung der Mark."
[8] See pages 651–653.

nature of their historical development, their structure is not uniform. They have chiefly in common a tendency to exclude considerations of profit from their business activities. They take care of the financial operations of the State, undertake to float loans, to administer State funds, etc. The earnings of the State banks go into the treasuries of the individual States. Besides their official duties, they have certain special statutory duties chiefly related to credit advances to various corporations within the State in question — such as communal and coöperative credits, etc., and land mortgage credits. Personal credit is less frequently advanced. Considering the size of the States, only the Prussian State Bank and the Prussian Central Coöperative Bank (Preussenkasse) are significant factors in German economic life.

Prussian State Bank. The Prussian State Bank (Seehandlung) is expected to safeguard the interests of Prussia, and, with this end in view, it stands in a close relation to all the other banks. The importance of the Prussian Bank on the one hand and the Berlin Bourse on the other, has brought it about that the " Seehandlung " in the course of its development since 1870 has become, next to the Reichsbank, the most important institution in the German money market. In quite recent times its importance as a clearing center in the money market has grown somewhat less, as a result perhaps of the activity of the Reichs-Kredit-Gesellschaft and the expansion of the central clearing institutions (Girozentralen). On December 31, 1926, its balance sheet showed resources of about 1,000,000,000 R.M. as compared with 1,853,000,000 R.M. for the Deutsche Bank.

Prussian Central Coöperative Bank. The second large Prussian financial institution, the Prussian Central Coöperative Bank (Preussische Centralgenossenschaftskasse) is really no " Staatsbank " but it functions as a central organization for the coöperative system. On December 31, 1926, its resources totalled approximately 850,000,000 R.M. In contrast to the Prussian State Bank which is a pure State bank, the capital of the Preussenkasse consists of a contribution from the State to the amount of 33,586,200 R.M. and investments by the coöperative unions to the extent of 33,020,000 R.M., so that the State is left in control. Among the functions of the bank is that of granting loans with

interest to coöperative unions, to individual coöperatives, to agricultural loan offices (Darlehenskassen) in so far as the last named advance personal credits, to undertakings in which the Reich or one of the Federal States participates, etc. The Preussenkasse is therefore an institution engaged in the business of advancing personal credits and does not concern itself with the granting of land mortgage credits. To do so would conflict with its essential character as the head of the Prussian coöperative system which is based upon personal credit.

Besides these important State banks, there are still others, for example the Bayerische Staatsbank, the Saechsische Staatsbank, the Braunschweigische Staatsbank and some of lesser importance.

v. Different Types of Smaller Public Credit Institutions. The great number of public banking institutions existing in Germany is to be explained chiefly on historical grounds, and can be attributed also to the modern emphasis on public welfare, and the tenacity with which such conceptions are cherished. In addition to the State Banks, organizations have been created in the provinces, the cities and the communes. Space does not permit a detailed examination of their structure and only the most important types will be mentioned and their significance explained. First there are the provincial banks (Landesbanken) of the individual Prussian provinces. Their business resembles in many respects, even geographically speaking, that of the Staatsbanken of the smaller states. There are also similar institutions established by the Prussian provinces in connection with local savings offices and clearing organizations (Giroverbaende), (so-called provincial banks). To facilitate the removal of the burdens which rested upon farmers' properties from feudal times, Rentenbanken were established in Prussia in 1850 for the several provinces. The liberation of the land was carried through by substituting for the rights of the feudal owner a rent liability upon the property in question. The mobilization of the latter was undertaken by the newly created Rentenbanken which issued Rentenbriefe. The Rentenbanken may therefore be regarded as special institutions with tasks which in course of time may be regarded as largely self-liquidating. So-called Landeskultur-Rentenbanken are devoted to the improvement of the soil. Fi-

nally special banks have been established by districts, and cities (Kreisbanken, Stadtbanken, etc.) but there are no institutions of especial importance among them.

VI. THE LANDSCHAFTEN. The last named group has been mentioned solely in the interests of giving a complete summary. The system of Landschaften, however, with credit unions based upon a social and occupational status, embodies a valuable principle which has stood the test of 150 years of experience.

The Landschaften and the Stadtschaften modeled upon them almost one hundred years later, as well as the Industrieschaften in process of development, represent a typical form of credit creation in which a number of elements of the German economic structure are recognizable. The Landschaften are unions formed by the landowners whose only purpose is to obtain for their members long-term land mortgage credits. Closely related to these organizations are a series of very old agricultural credit unions (mostly feudal credit corporations) which serve the same class of people as the Landschaften. These feudal corporations, however, do not confine themselves exclusively to agricultural mortgage credits. They deal also in personal credits and in this regard approach in character the many ordinary coöperative organizations. The Landschaften have a membership restricted by statute usually to the union (Vereinigung) of landed proprietors of a province. The Landschaften are empowered to issue bonds against the security of mortgage loans granted by them. These agricultural mortgage bonds together with ordinary mortgage bonds add to the extent of the market for fixed interest-bearing securities.

The principle of joint liability for the obligations assumed by a union is common to the Landschaften as well as to the German coöperatives known as Genossenschaften. This joint liability likewise, as in the case of the Genossenschaften, may be limited in various ways or it may be quite unlimited.

The legal foundation for the Landschaften rests upon their statutes which are quite similar. Nevertheless a differentiation is made historically between the older Landschaften (antedating the nineteenth century) and the newer ones. While the older compulsory union of the landowners of a particular district originally

included only the properties of the landed nobility, the later ones require express consent of prospective farmer-members. Moreover, the difference between the estates of the nobility and of others has from the beginning been ignored, but administrative details would carry the discussion too far afield. The sole activity of the Landschaften consists, as previously said, in granting loans to agricultural unions and issuing mortgage bonds to a corresponding amount. All further details, such for instance as questions of priority, methods of appraisal, etc., correspond to the German mortgage bank system as described in more detail in the section dealing with mortgage banks. It should not be forgotten that the loan operations of the Landschaften are not modeled upon those of the mortgage banks. The mortgage bond system of the Landschaften, on the contrary, formed the basis for the development of the mortgage bond business of the private joint stock mortgage banks beginning about 1862. Naturally the Landschaften belong to the institutions to which the German Rentenbank-Kredit-Anstalt transfers credits intended for agriculture for direct distribution.

During the period of inflation the Landschaften issued mortgage bonds in terms of rye (Roggenpfandbriefe) and later they began to issue agricultural gold mortgage bonds. The revaluation of the agricultural mortgage bonds issued before the war, which were drawn in terms of the marks of the German imperial currency system, was managed in a fashion similar to that employed for the mortgage bonds of the mortgage banks. A participation pool representing all the revalued mortgages was equitably apportioned among the mortgage bonds subject to revaluation.

THE SILESIAN LANDSCHAFT. The oldest Landschaft is the Silesian Landschaft in Breslau founded by Frederick the Great in 1770. It owes its origin to the then developing ideas regarding the mobilization of land mortgage credits (John Law in France and later the assignats). Its establishment was also encouraged by the quite natural efforts of the great king to lend assistance through credit institutions to the officer class totally impoverished by the war. This also explains the original difference between the noble and the peasant properties. Because of the feudal burdens resting upon them, the peasants, as a matter of fact, could

hardly have coöperated until 1850 in the formation of credit unions.

The Zentrallandschaft. In 1873 a number of Landschaften and institutions similar to them came together to form a Zentrallandschaft which subsequently issued so-called Zentral-Pfandbriefe, although the individual rights of issue of the several members remained in existence. On December 31, 1913 there was outstanding a total of about 3,000,000,000 marks of the " Landschaftliche " mortgage bonds of which the Silesian Landschaft was credited with 644,000,000 marks. The second largest Landschaft, the Ostpreussische (East Prussian) participated to the extent of 784,000,000 marks while the mortgage bonds of the Zentrallandschaft totalled 516,000,000 marks. On December 31, 1924 the amount of mortgage bonds outstanding amounted to 304,000,000 R.M. — mostly rye values. On December 31, 1926 they reached 668,000,000 R.M. (rye and gold). These totals are exclusive of new issues made for the liquidation of revalued paper mark mortgage bonds.

City Mortgage Institutions. The excellent results which Prussia had obtained with its Landschaften in granting agricultural credit upon a coöperative basis, led to the establishment of a rapidly increasing number of city credit unions from 1905, following various undertakings which were started in the nineteenth century. This development became more systematic, however, after 1919, at which time the name Stadtschaft began to gain currency. Eleven Stadtschaften, located in a number of the most important Prussian cities, date from that period. There is one in Berlin which is likewise the seat of the Stadtschaft of the Province of Brandenburg and of the Prussian Zentralstadtschaft. Other Stadtschaften are to be found in Hanover, Koenigsberg, Stettin, Breslau and elsewhere. The Stadtschaften are engaged in the business of granting amortization loans to the owners of improved real estate or of land in process of being developed. In their organization, their regulations, etc., they resemble the Landschaften (liability of the members, for example). Still existing peculiarities, characteristics of the older Landschaften, have been correspondingly modernized. In the non-Prussian states there are isolated instances of institutions issuing mortgage bonds which provide realty credits upon a city or communal basis.

Industrieschaft. Quite recently attempts have been made to extend the idea of the Landschaft to the field of small industries and handicrafts. Dr. Pabst has coined the word Industrieschaft for these undertakings. While the coöperative organization idea was naturally of less importance in the large cities, the idea of rendering the borrowers additionally liable to a limited extent, depending upon the amount of the loan, is modeled upon the principle of joint liability of the Landschaften and the German coöperative principle. As yet there is only one Industrieschaft, the Saxon Landespfandbrief-Anstalt, with a capital of 1,000,000 R.M. supplied by the State. It has the right to issue industrial mortgage bonds to the amount of 50,000,000 R.M. The Saxon Landespfandbrief-Anstalt has issued 7% and 6% dollar bonds as well as 8% gold mortgage bonds.

vii. Central Clearing Institutions. The central clearing institutions (Girozentralen) should be mentioned as the last group of public credit institutions. Their main purpose is to facilitate the technique of payment. They owe their establishment to coöperation between the savings bank unions and the Government, which is naturally strongly interested in development of a system to conserve savings and make them more efficient. They constitute the third great clearing circle in the German currency system in addition to the Reichsbank-Giro and Postscheck-Giro with which they are in communication. The expansion of these institutions, although planned before the war, dates from recent years. As clearing centers for the communes, the Girozentralen are of the greatest importance. Furthermore, the Girozentralen serve to bring about an equalization between demand and supply, as heretofore individual cities might have excess supplies of capital while elsewhere, as in the Eastern Provinces, there was a painful dearth of funds.

Reichs-Kredit-Gesellschaft. An interesting example of private banking activity on the part of the State is illustrated by the Reichs-Kredit-Gesellschaft A. G., Berlin, which was founded after the war. Its entire share capital of 30,000,000 R.M. is held in the portfolio of the Viag (Vereinigte Industrie Aktien Gesellschaft) which belongs to the Reich. The Viag is a holding company for various industrial undertakings, legacies in part of the war-time industrial régime. The Reichs-Kredit-Gesellschaft

has been able to maintain its position very well in competition with the private Grossbanken. Its balance sheet in 1926 closed with a total of 516,000,000 R.M. and a net profit of 6,200,000 R.M. It has no branches, but nevertheless has close connections with all the provincial institutions and the provincial bankers, acting as a clearing center for them to a certain extent. In this respect its circle of customers touches that of the Prussian Seehandlung.

Labor Banking. Labor banks are a type of institution which are at present of slight importance in Germany. The reasons for this are partly social, and partly due to the extensive development of the savings and coöperative organizations.

THE PRIVATE MORTGAGE CREDIT INSTITUTIONS

The Landschaften, Rentenbanken, Landeskultur-Rentenbanken and various other public credit institutions are the chief agencies for the granting of agricultural mortgage credits, while agricultural personal credit is for the most part furnished by the rural coöperatives (Genossenschaften). The private mortgage banks have, on the other hand, in course of time more and more limited their agricultural loans and have concentrated their business activities in the cities. These mortgage banks embody much more clearly than do the Landschaften, in which historical and hierarchical factors have always played a considerable rôle, the principles of land mortgage credit so characteristic of the German credit economy.

If one disregards all accessory activities, which are as a matter of fact severely circumscribed, there remains but a single activity peculiar to the mortgage bank and, theoretically at least, one corresponding liability. The " active " business, representing assets, consists in the granting of mortgages, and the " passive " business, resulting in the creation of liabilities, is the issue of mortgage bonds which are secured by the entire volume of negotiated mortgages.

Legal Foundations of Mortgage Credits. The basis for the high degree of perfection to which the German mortgage bond system has attained is due to the German conception of a lien (Pfandrecht) and especially the institution of the realty register

(Grundbuch). The German " Pfandrecht " recognizes various kinds of mortgage indebtedness. In addition to the " Hypothek " for which the debtor is always primarily liable and the mortgaged property only secondarily so, there exists the " Grundschuld " for which the land itself is directly liable without any personal debt being recognized. Finally there is the " Rentenschuld " which does not rest on capital at all but is simply a charge in the form of certain fixed annuities. The German " Pfandrecht " recognizes a so-called succession principle according to which a second mortgage automatically becomes a first lien after the first mortgage is liquidated. The realty registers established in various localities dating back to the thirteenth century, embrace the entire territory within their jurisdiction. Their importance lies in the fact that from them it is easy to establish the property relationships and the debt burden of every piece of land. Every interested person has the right to ask to examine the register (Grundbuch). A uniform regulation for the entire Reich was secured by the Grundbuchordnung of 1897, by which dealings in landed property are greatly facilitated.

The marketability of the mortgage bond is assured by acceptance of the principle of undifferentiated security which means that for purposes of repayment, no bond is " tied to " any particular mortgage. The recognized principle — it cannot be too often repeated — is that of *general* and not *special* cover for the mortgage bonds. Naturally the mortgage bank is in addition liable to the extent of its own property. There is besides a far-reaching regulation on the part of the State combined with continual State supervision. All these factors tend to eliminate differences in value between successive issues of mortgage bonds regardless of whether they are issued by the same or by different banks. In fact, the level of quotations for the German mortgage bonds, which at the outbreak of the war amounted to about 11,000,000,000 marks, was fairly uniform, so far as differences were not caused by variations in the rate of interest. The immense importance of such a capital sum to German economic existence can be best appreciated by contrasting it with the amount of all German savings deposits which before the outbreak of the war totalled 16,000,000,000 marks and, including loans of the Reich, the Federal States and the communes, reached 31,200,000,000

marks. All the efforts of the administration were directed toward providing for the security of the holders of mortgage bonds.

SUPERVISION OF MORTGAGE BANKS. As the activities of the individual institutions were not confined within the boundaries of the separate States, imperial regulation of the system of mortgage banks was urged soon after the founding of the Reich. The first project for such a law dates from 1879 but it was only after the codification of German law (civil and commercial) had provided the legal foundations, that the regulation of the system of mortgage banks was completed with the passage of a law which came into force January 1, 1900.

As will be explained further, the German mortgage bank law was framed with reference to various deficiencies which had developed in the case of individual institutions. In respect to the customers of the mortgage banks the law on the one hand contains provisions concerning the rights and duties of the banks in relation to the landed property for which loans are being sought, while on the other hand, there are provisions regarding the mortgage bonds to be placed with the public. This imperial law was expanded in the case of Prussia only, by a detailed decree of the Prussian Ministry for Agriculture of November 28, 1901, which stands in close connection with the crisis that threatened various Berlin mortgage banks. It contains severer regulations regarding State supervision of the banks and the obligation to make public their transactions. Likewise applicable to Prussia alone is another law, which relates to the upper limits of lending, one of the most important questions which concerns the relation of the customers of the mortgage banks to landed property. This law is the Schaetzungsamtgesetz of June 8, 1918. On the other hand, the relations between the mortgage banks and the owners of mortgage bonds were defined by the law governing the common rights of the owners of debt obligations (December 4, 1899 and May 14, 1914).

This law covers not only the owners of mortgage bonds but also the owners of the bonds (Schuldverschreibungen) of railway companies or industrial concerns. On the other hand, it does not apply to the obligations of public corporations. This particular law has already been briefly mentioned, but as it applies chiefly to holders of mortgage bonds it is discussed in connection with the Mortgage Bank Law.

The Mortgage Bank Law (Hypothekenbankgesetz) requires that the permission of the State shall be secured for the establishment of a mortgage bank — a requirement which held for banks in general until 1870. It was reintroduced in the case of mortgage banks out of consideration for the fact that the public, through its holdings of mortgage bonds, is much more concerned in the fate of the mortgage institutions than in that of the credit banks. The business operations of the mortgage banks are subjected to supervision by the State and it may be noted in passing that this right of supervision is a very far-reaching one although the duty of supervision naturally does not extend to making the State responsible for the conduct of the mortgage banks. Materially speaking, therefore, supervision, so far as the public is concerned, is resultless. In this respect there is a very fundamental difference between the mortgage banks and the public credit institutions, and the savings banks, too, for which, if not the State, then as a rule some other public corporation, such as a city or community, acts as guarantor. In addition to State supervision of the mortgage banks, there are extensive publicity requirements which go far beyond the bi-monthly balance-sheets demanded of the credit banks.

The business of the mortgage banks, according to the law, consists in mortgage loans on hand, combined with the issue of bonds (Schuldverschreibungen) based on the acquired mortgages. In the case of mortgage banks, the joint-stock company and the limited liability company issuing shares are the only forms of organization permitted, while in practice only joint-stock companies are found. Institutions previously existing in other forms are permitted to continue functioning but are altogether unimportant. Another exception to the legal regulation is found in the so-called mixed mortgage banks, of which there are a number in good standing in Bavaria. As already mentioned, there had developed there, as in Austria, the usual type of mixed mortgage banks and these were expressly permitted by law to continue to function in their existing form. In the future, however, no mixed mortgage banks may be established. The numerous public mortgage institutions naturally remained untouched by the mortgage bank law.

Functions of "Pure" Mortgage Banks. The law prescribes the scope of the activities which the "pure" mortgage banks may

pursue. In addition to granting mortgages and issuing mortgage bonds, the banks may undertake only the following activities:

(1) Certain functions which may be regarded as a variant of the mortgage business itself; namely, the acquisition and sale of mortgages already existing, naturally in accordance with the standards which are applicable to the granting of a mortgage by the bank itself; further, the granting of non-mortgage loans to domestic public corporations with full guarantees of such a corporation; the issuing of Schuldverschreibungen on the security of such loans (usually called communal bonds); finally, the granting of loans to domestic narrow-gauge railways (Kleinbahnen) against a mortgage of the railway system and the issuing of bonds (Schuldverschreibungen) against the advances. The activities just enumerated are evidently only variants of the actual business of lending on mortgage.

(2) Certain sorts of commission business, as for example the purchase and sale of securities for foreign account, in which through a series of protective measures any liability on the part of the Bank itself is excluded.

(3) The receipt of deposits up to 50% of the paid-in capital of the bank.

(4) The mortgage banks may place their free funds with qualified bank houses, though they may not grant any "credits" themselves. They may also utilize such funds to buy in their own mortgage bonds (in practice this is the most important outlet); finally they may buy bills and securities through the agency of the Reichsbank and make loans on securities. The last-named operations are limited to a list drawn up by the management, subject to approval by the State, which must also include lending rates. The acquisition of land is only permitted to the mortgage banks in order to safeguard them against loss (in cases in which they have loaned against these properties). As a matter of course, real estate property for their own use may also be acquired.

There are innumerable regulations dealing with the issue of mortgage bonds. For instance, the issue of mortgage bonds, which

may be called for payment by the holder or which involve liabilities in excess of par values, is forbidden. The bank, for its part, may postpone the right to demand repayment for a maximum period of ten years. In practice, a majority of institutions limit this period to five years so that most of the mortgage bond issues of the past year are not callable until 1931 or 1932. More important are the provisions that the mortgage bonds outstanding must at all times be covered by mortgages to a like amount, yielding like returns in interest. If this cover should temporarily prove to be insufficient as a result, for instance, of repayment of mortgages, it may for the time being be replaced by State obligations. The mortgage bond circulation is further limited in that it may never exceed twenty times (originally 15 times) the property of the bank, that is, the paid-in capital and the reserve funds. This so-called " Bepfandbriefungsgrenze " is not a fixed amount, but it results in forcing the mortgage banks to raise their capital from time to time as the limits of their rights to issue bonds are reached.

For the determination of the loan limit, the mortgage bank law confines itself to certain general principles in accordance with which the individual mortgage banks must work out their internal lending policies.

As already mentioned, a uniform regulation was adopted in Prussia, requiring the establishment in every district (Kreis) of an appraisal office (Schaetzungsamt). To give details of this law would lead too far afield. Lending is limited by the mortgage bank law to land within the country and as a rule is confined to first mortgages. The loan is not to exceed three-fifths of the value of the land and in Bavaria, in the case of city real estate, it may not exceed 50%. Value is defined as the ordinary value that the property has for each owner.

Among the many details in regard to the publicity requirements of the mortgage banks, the following may be mentioned: the booking of the premiums or discounts respectively, growing out of the issue of mortgage bonds, as well as the amount of mortgage interest in arrears, the number of forced sales, the number of cases in which the Bank, in order to avoid losses, must take over lands, and the profit or loss resulting from such transactions.

The mortgage bond holders in case of bankruptcy have a certain preferred right over all other creditors, but as a class they

have the same status irrespective of the date of the various bond issues. This adds greatly to the marketability of the mortgage bonds.

COMMON RIGHTS OF BONDHOLDERS

In order to make easy the enforcement of the claims of the mortgage bond creditors, the above-mentioned law relating to the common rights of the owners of bonds was passed. To justify resort to the law there must be a number of fully and equally justified claims represented by bonds. It is immaterial whether such claims are " real " or personal. In applying the law, certain limitations upon the amounts involved are important. For example, the sum of the outstanding bonds may not be less than 300,000 R.M., etc. In order to make it possible to meet the various conditions, owners of bonds may form a union whose decisions with specified restrictions will be binding upon all the holders of bonds. The rights and position of this union (Verband) in relation to the debtor are comparable to those of a group of shareholders in relation to a company. So-called " Quora " are established for this union, that is, percentages which regulate amounts to be called in, etc. The creditors' union can appoint a common representative. In the case of the debtor, that is, the mortgage bank, bonds held by the bank in its own treasury are excluded from voting upon the resolutions of the creditor unions.

Development of Mortgage Banks. The mortgage banks were established like the credit banks, relatively late, after 1862. The Bayerische Hypotheken- und Wechselbank, founded in 1835, one of the oldest and most reputable of the German banking institutions, still carries on a " mixed " banking business, combining the activities of a mortgage bank with those of a credit bank. However, the mortgage branch of the business dates only from the year 1864. The number of mortgage banks has for some time stayed at a figure somewhat above thirty. Concentration movements in the nature of fusions have rarely occurred. There have been various obstacles in the way, due to the legal view that a fusion brings to an end the independent existence of the institutions concerned. As a result, in cases of liquidation, the holder of a mortgage bond is entitled to demand repayment at once. In-

stead of amalgamations such as occurred after 1900 in the case of the credit banks, only a relatively loose grouping is to be found among the mortgage banks, as shown below. Institutions not included in the table are independent.

Name of Group	Number of Institutions	Share Capital		Reserves		Mortgage Bonds Outstanding	
		1913	1927	1913	1927	1913	1927
		In millions-marks and Reichsmarks					
Gemeinschaftsgruppe Deutscher Hypothekenbanken	8	146	55	46	15	2358	531
Gruppe Preussische Centralboden	4	95	35	27	10	1841	360
Sueddeutsche Gruppe	5	108	33	71	11	2225	216

Mortgage Bank Crises. During the first decades of their activity (before the passage of the mortgage bank law) the mortgage banks had to weather a number of crises. In Prussia this was due in part to the fact that the mortgage banks were called on by the government through all sorts of bureaucratic devices to advance loans for agricultural purposes. As economic development, from 1870 on, led to increasing industrialization and growth of the cities, the mortgage banks in many cases were consequently forced to take over estates on which they had made loans.

Such unfortunate experiences induced the mortgage banks, as previously stated, to turn more and more toward loans on city property. This resulted in expanding the scope of the activities of the rural mortgage credit institutions. The first crisis to overtake the Prussian mortgage banks came in 1880. The Prussian Hypothekenaktienbank and the Pomeranian Hypothekenaktienbank which in 1900 precipitated one of the greatest of the German banking crises, excited even at that time some very unpleasant comment. The Grund-Kreditbank in Gotha fell into difficulties and had to be reorganized by the provincial administration. The crisis of 1900, to which reference has been made, started with the collapse of the previously mentioned Berlin institutions and affili-

ated concerns. The mortgage bank law had been passed shortly before this time. It provided that the legally prescribed cover for the mortgage bonds should be delivered to a trustee. The two institutions in question were not able to comply. The reasons for their inability were in part of long standing but they were also due to the serious neglect of their directors who were punished with prison sentences.

In spite of the discredit attaching for the time being to the mortgage business the mortgage banks succeeded in the years that followed in regaining the confidence of the public. The volume of the mortgage bond circulation in 1913 is the best evidence of that fact. The attitude of the public was probably due to a realization that the regulations of 1900 had brought to light already existing irregularities in the two institutions, and that the amended mortgage bank law would in the future prevent recurrence of such happenings.

During the war and inflation years the mortgage business played no great rôle. There are a number of pertinent reasons why this should be the case in times of war and inflation, when the purchasing power of money is falling. Furthermore, in Germany, as in some neighboring states, the protection afforded to tenants reduced the revenue value of city property to a minimum.

At the end of the inflation period, the mortgage banks, as well as the Landschaften, both of which had resorted to rye mortgages and rye mortgage bonds, were in a quite serious situation. Their capital and the large reserves which they had assembled during peace time were almost entirely invested in paper mark securities — so that their situation was much worse than that of the banks. The position of the mortgage banks was greatly improved through the revaluation law, which provided that the mortgages in which the greater part of their own property was invested should be revalued in principle at 25% of the pre-war figure. The rather complicated procedure for revaluation of the mortgage bond issues will be discussed later. In spite of the revaluation, the gold balance sheets of the mortgage banks revealed greatly shrunken property holdings, in some instances reduced to one-tenth of the pre-war figure. In the succeeding period, however, considerable revenues of an extraordinary sort came to them

from two different sources. In the first place there were fees for administrative costs, which the mortgage banks were permitted to levy as compensation for carrying through mortgage bond revaluation. These fees enriched the much depleted capital of the banks in many instances. The second great source of income came from new loans. The end of inflation found all mortgage debtors without funds so that new loans were much needed. At the same time inflation had brought about a far-reaching "Grundbuchsbereinigung," that is, elimination of mortgage debt. A great deal of landed property which before the war had been mortgaged to the limit, was now unencumbered or, at most, carried only one-fourth of the pre-war figure, corresponding to the revaluation rate.

After 1925 and 1926 — years devoted to recuperation — new lending became very active. A beginning had been made in 1925 with a 10% type of gold mortgage bond, while 8% was the prevailing rate during the greater part of 1926. By the turn of the year 1926–27 the rate of interest dropped to 7%. Besides a regular revenue arising from a certain interest margin, profits of the mortgage banks consist of the "spread." In the beginning this was 4% or 5% and, by the middle of 1926, it was about 3%. Out of this "spread" the mortgage banks had to cover the commission which, as compared with other kinds of security issues, is relatively high in the case of mortgage bonds. However, it can be assumed that new loans brought the mortgage banks an initial profit of 2% and recently 1%. The level of new loans amounts now (August, 1927) to about 17% of the pre-war total, not including mortgage bonds in process of liquidation. In recent months the mortgage banks have tried, and with success, to find an outlet for their bonds in foreign countries. The further development of the German mortgage banks will progress hand in hand with the growing strength of the domestic capital market. Since the setting up of gold balance sheets, some mortgage banks have already been forced in accordance with the provisions governing mortgage operations, to raise their capital in order to maintain the correct relation between capital and outstanding bond issues.

Methods of Revaluing Mortgage Bonds. As stated, the revaluation of the present mortgage claims was in general fixed at 25%, but the conditions for revaluation are especially compli-

cated because a multiplicity of debts represented by mortgages are set off against a multiplicity of claims represented by the mortgage bonds. In this respect the task is immensely difficult in comparison with the revaluation of industrial bonds in which case a single debtor (the industrial company) is opposed to a number of creditors (the bondholders). It may be mentioned here that the principles that govern revaluation of mortgages and mortgage bonds also apply to similar issues such as the bonds of the public Landschaften and also the Rentenbriefe of the Prussian Rentenbank.

In the case of the revaluation of the pre-war mortgage bonds issued by the mortgage banks, the whole amount of mortgages to be revalued by each bank is brought together by the bank which administers the property as trustee. While it was relatively easy to determine the amount of the claims of the pre-war mortgage bonds according to the date of their issue, the fixation of the total amount to be divided was for various reasons decidedly more difficult. For immediate inclusion in the total sum, for instance, there were available only those pre-war mortgages which during the inflation years had remained untouched. Often the mortgage debtors had taken advantage of the depreciation of the currency to make a premature repayment in depreciated paper marks. In such cases the revaluation law had retroactive effect to June 15, 1922 — the date officially recognized as the beginning of inflation. Payments made prior to that time were considered to have extinguished, or, as the case might be, to have reduced the mortgage debt. For later payments only the actual value (according to the current rate of the paper mark in terms of the gold mark) was taken into consideration in connection with the 25% revaluation. For the uncovered remainder the mortgage bank had to enter a so-called retroactive mortgage and at this point the difficulties began. At first, all those mortgages which were placed against security that had been alienated had to be dropped. For example, on lands lost by the Peace Treaty (Poland) there was no possibility of entering retroactive mortgages. Further complications resulted from loss of priority. Until revaluation had been determined by law, the debtor naturally had the right after making repayment in worthless paper marks to demand the elimination from the realty register of the pre-war mortgage

entered there. If, in the meantime, prior to the carrying through of the revaluation plan he had placed a new mortgage constituting a first charge upon his property, the revalued mortgage, after being reëntered, had to be subordinated to the new claim. During the period of inflation it happened constantly that land changed hands after the extinguishment of the pre-war mortgages. In this case a retroactive entering of the mortgages to be revalued was impossible, as the new owner could point to the formal position of his property in the realty register at the time of his purchase. In this case there existed only a personal claim against the previous owner which was not backed by any sort of material security.

Interest allowed on the revalued mortgages is also included in the participation pool (Teilungsmasse). Without regard to previous interest charge, rates were uniformly fixed by law at 3% during 1927 and 5% thereafter. As compensation for their administrative work, the mortgage banks received 8% of the amount of the revalued mortgages included in the total sum to be apportioned. The success which the individual mortgage banks had in keeping and in recovering possession of mortgages to be revalued, determined the size of the quota assignable to each pre-war mortgage bond. This quota is consequently different for each bank.

The allocation of the revalued total among the individual owners of mortgage bonds is in most cases being carried through gradually by the mortgage banks. The mortgage bond creditors receive payment on account for the greater part of their claims in the form of " Liquidationspfandbriefe " carrying interest at 4.5%, drawn in gold marks. Against the rest of the claims represented by the participation pool (Teilungsmasse), special certificates of rights are issued. As these claims are established, a further distribution of " Liquidationspfandbriefe " follows. In this way the entire volume of obligations subject to revaluation is being converted into 4.5% " Liquidationspfandbriefe." From the standpoint of the claimants, this arrangement has the advantage of giving them a marketable security that can be dealt in on the Bourse, in place of a mere right to revaluation. The redemption of these " Liquidationspfandbriefe," which, in view of their origin are of a provisional nature, takes place, as in the case of ordinary

mortgage bonds, when the revalued mortgages which they represent (held in the participation pool) fall due.

There is no uniform period set for the repayment of the revalued mortgages. Those which have a moderate length of time to run (five years, as a rule) — and that includes the majority — are due January 2, 1932. In case of the long-dated mortgages, running usually for thirty years, subject to amortization, the old plan of amortizing them came into force which involves extension of payment far beyond 1932. Experience has shown that a large number of debtors when placing a new mortgage undertook to make an advance payment of revaluation liabilities. Even if there is not complete amortization of the revalued mortgages and the " Liquidationspfandbriefe " by January 2, 1932, amortization will nevertheless have made great strides by that time.

CREDIT BANKS

A discussion of the German banking system necessarily calls for a treatment of the well-known Grossbanken. In order that the non-commercial banking field might be surveyed first, it was decided to leave a discussion of the private credit banks (Kreditbanken) until the end. There are in fact many comprehensive works which describe in minute detail the system represented by the Grossbanken. Among the standard works mention may be made of Dr. Riesser's *Die Deutschen Grossbanken und ihre Konzentration,* Fourth edition, Jena, 1912, also Alfred Bosenick, *Neudeutsche Gemischte Bankwirtschaft,* Munich and Berlin, 1912. Additional references will be found in the appended bibliography. These studies necessarily present a false picture, for the figures of turnover show that a large part of the credit operations pertaining to banking are not transacted through the instrumentality of the private credit banks but through the instrumentality of the mortgage banks and of the public institutions. Moreover, there is the further fact that Germany to a much greater extent than England, for example, dispenses with banks and relies upon the typical German coöperative organizations, savings institutions, etc. Without doubt the German Grossbanken, in respect to the variety of their activities and the

rapidity of their development since the middle of the preceding century, are among the most astonishing phenomena of German economic life.

Rise of German Joint Stock Banks. A historical survey reveals the fact that the joint stock credit banks were relatively late in developing. Until their rise the business of lending was left to private bankers on the one hand and to the Landschaften and other land mortgage credit institutions on the other hand. The rise of the German joint stock banks has gone hand in hand with the industrialization of the country. Before 1830 there was practically no trace of industrialism due to warfare, the industrial supremacy of England, etc. And even prior to 1870, too, it must not be forgotten that France was bound to southern Germany by many ties and that in consequence the financial development of Germany followed along lines not so very different from that of France.

Organization of the Joint Stock Banks. The first German joint stock bank was founded in the year 1848 as successor to the Rhenish banking house of A. Schaaffhausen. It was the A. Schaffhausen'scher Bankverein in Cologne founded with the assistance of the Prussian State with a capital of 5,187,000 talers originally, the equivalent of 15,600,000 marks. Of this sum, however, only 3,199,800 talers was paid in. In 1851 the Disconto-Gesellschaft was founded, first as a Kredit-Gesellschaft, later transformed into its present form of Kommandit-Gesellschaft auf Aktien (limited liability joint stock company). Its capital of 30,000,000 marks was for that time quite high. The Darmstaedter Bank dates from 1853 with a share capital of 42,750,000 marks of which 17,000,000 marks was issued. In 1856 the Berliner Handels-Gesellschaft was established with a capital of 45,000,000 marks of which 11,240,450 marks was issued. In these years the development of the German credit banks paralleled that of the French Credit Mobilier, after which they were in part modeled.

Establishment of the Deutsche Bank. In 1870 there came a turning-point not only politically but financially speaking through the establishment of the Deutsche Bank which is one of the newer of the German Grossbanken. The course of action pursued by the Deutsche Bank carried it through the crisis year 1873

to the final development of the type of Grossbank that, from about 1900 until 1914, dominated German economic life far more than it does today. Differences between the Deutsche Bank and the other Grossbanken and especially the French Credit Mobilier lay in the sharp and conscious stamp of universality emphasized by the former. Whereas the other banks had conceived their chief function to be the fostering of trade and industry the Deutsche Bank from the beginning added to this line of activity an overseas and deposit business. The Dresdner Bank was founded in 1872 with a capital of 24,000,000 marks of which 9,600,000 marks was paid in.

Crisis of 1901. In 1891–94 came depression and the collapse of many Berlin banks, and this led to a Bourse Commission of Inquiry, the result of which was the passage of the " Depot " Law of 1896. The crisis of 1901 was of great importance for the development of the German banking system, for it is generally thought of in connection with the collapse of the Leipziger Bank. In 1900, after a brilliant period of advance from the year 1895, business entered a phase characterized by a very high degree of tension. This tension was heightened in the capital market by the fact that the business crisis coincided with a number of important legal regulations of the bourse system. About 1896, for instance, measures had been adopted calculated in various ways to have a retarding influence upon banking. First there was a sharp increase in the tax on bourse share dealings, then came restrictions upon stock exchange business which forced an increase in cash holdings and led to capital increases in a good many cases. For example, the Deutsche Bank in 1895 raised its capital from 75,000,000 marks to 100,000,000 marks with the explanation that the increase was intended as a protection against the operation of the new bourse law. As these capital increases were issued at a high premium (150% in case of the Deutsche Bank) the influence upon the money market was considerable. A further consequence of these various measures, which include the Depotgesetz of 1896, was the beginning of a far-reaching concentration movement initiated by a union of interests (Interessengemeinschaft) including the Deutsche Bank, the Bergisch-Maerkische Bank and the Silesian Bankverein. In the succeeding years the leading banks competed actively in the absorption of smaller in-

stitutions. This unbroken progress of the banks for a period of five years (1895–1900) went hand in hand with a corresponding advance of industry. The development was marked by the formation of the Rhenish-Westphalian Pig Iron Syndicate as well as by the Rhenish-Westphalian Coal Syndicate. When, therefore, in 1900 the crisis came, many circumstances combined to intensify its effect. The crisis started, as noted previously, with the Leipziger Bank which closed its doors June 25. The Bank, which had a capital of 48,000,000 marks and hence closely approached the class of Grossbanken at that time, belonged to the most highly regarded banks of the province. As the resultant investigation made clear, the bank had loaned through its management no less than 93,000,000 marks to an affiliated concern, the Trebertrocknungsgesellschaft in Cassel, mostly against bills of the latter. The undertaking which, as its name shows, was chiefly concerned with agricultural operations and controlled very valuable patents proved to be a veritable paper creation (Potemkisches Dorf). On the same day that the Leipziger Bank closed, it received assistance from the Deutsche Bank which thereby prevented a crisis that would have been most disastrous.

The following statistics illustrate the extent of the industrial crisis which occurred over the end of the year (1901).

	Capital New Share	Average quotations of shares of the five Berlin Grossbanken
1897	254 cos. with 380,000,000 marks capital.........	181%
1898	239 " " 463 " " "	179
1899	364 " " 544 " " "	175
1900	261 " " 340 " " "	159
1901	158 " " 158 " " "	154
1902	87 " " 118 " " "	168
1903	84 " " 300 " " "	176
1904	104 " " 140 " " "	179
1905	192 " " 386 " " "	185

Results of Crisis of 1901. In case of the mortgage banks the more serious bankruptcies also occurred in these years. The consequences of the crisis of 1900–01 for the German banking system were multiform. For the mortgage banks it resulted in the passage of more stringent regulations, and since then there have in

fact been no serious difficulties with these institutions in spite of the war years and inflation. In the case of the credit banks the crisis led to a more pronounced concentration movement. In this connection it may be noted that even the bi-monthly balance sheets required now of the credit banks would have failed, as in the case of the Leipziger Bank, to reveal their true condition. For example, as the credits granted to the Trebertrocknungsgesellschaft for the most part were covered by bills held in the portfolio of the Leipziger Bank, the balance sheet up to the time of the crisis presented a surprising and as it turned out, false impression of liquidity.

Important Position of the Joint Stock Banks, 1902–1912. The decade following the crisis of 1900–01 (that is 1902–1912) may be described as the climax of the development of the German credit banks which at that time reached a position that far surpassed their present-day importance. In the section on the Reichsbank, mention has been made of the negotiations pursued for some years between the Reichsbank on the one hand and the government agencies and the Grossbanken on the other. The first fruits of these interchanges were the bi-monthly balance sheets which were first printed in 1910.

The German Grossbanken, under the direction of the Seehandlung, undertook the task of financing the long-term needs of the State (for example, the Prussian Konsortium). They also extended their operations into neighboring countries cooperating with leading banks as, for example, the Rothschild group in the flotation of Austro-Hungarian loans. They regarded themselves as financial outposts of German foreign policy and the best known illustration of this is the Eastern policy of the Deutsche Bank in financing the Anatolian and Bagdad Railway.

The Credit Banks, 1914–1924. From 1914 up to the time of stabilization there were few events of importance connected with the history of the credit banks, but since then they have marched at the head of German economic development.

Balance Sheets of the Credit Banks. The gold balance sheets of the leading institutions reveal a marked reduction in assets as compared with the pre-war period as shown by the table at the top of the next page.

	I	II	III	IV
	Capital	Reserves	Real Estate	Deposits & Creditors Including Acceptances
		In millions of marks		
Deutsche Bank ...	1914—250.0	178.5	32.0	1,861.0
	1924—150.0	50.0	43.0	895.0
Disconto-	1914—300.0	118.97	18.0	924.0
Gesellschaft	1924—100.0	45.0	34.0	540.0
Dresdner Bank ...	1914—200.00	62.2	33.0	1,245.0
	1924— 78.0	22.0	31.0	686.0
Darmstaedter	1914—250.0	40.0	24.0	1,087.0
Nationalbank	1924— 60.0	40.0	25.0	674.0
(combined 1922)				

Their statements, appearing in advance of those of most of the industrial concerns, were, however, reassuring and as a result of agreements concluded among themselves the Grossbanken immediately after the publication of their gold balance sheets from 1924-1926 undertook to declare dividends in relatively large amounts. In this way they afforded great support to the German security market. It is generally assumed that the dividends which were distributed in 1924 and 1925 came only in part from current revenues while, on the other hand, the earnings of 1926 were decidedly in excess of the amounts distributed. Consequently there has been an equalization of earnings during the past three years.

Rationalization of Banking. Immediately after stabilization, the Grossbanken proceeded to reduce their personnel and otherwise " rationalize " their operations. Altogether the number of employees of the seven large banks fell from 63,000 in 1924 to about 47,000 at present. It has to be remembered, to be sure, that the immediate disappearance of a mass of ciphers (with the new rentenmark unit the previous writing of twelve ciphers was avoided) as well as the disappearance of an endless number of control measures, especially in the field of centralized exchange control, had a much greater effect upon the banks than upon undertakings which were not exclusively concerned with the bankrupt currency system. Nevertheless, it can be asserted that

the banks were ahead of other branches of economic activity in appreciating the altered situation and in turning from methods of inflationary financing. The Grossbanken have played an important rôle in recent economic developments, especially the Darmstaedter und National Bank under the leadership of Jacob Goldschmidt. Indeed, it is difficult to judge how far the reorganization processes completed in 1926 by German industry reflected original initiative and how far they were due to the instrumentality of the banks. Among the greatest of the combinations, and also the one internationally best known is that of the I. G. Farbenindustrie which occurred relatively early in 1925. It was almost a year later before this movement made further important progress. The combine in the I. G. Farbenindustrie sprang solely from the initiative of the industrial leaders. It should, however, be noted that the formal union of interests only revealed a development set in motion many years ago. In negotiations looking toward unification of divergent interests, mediation or even mild pressure by intervening banks may be necessary.

In rather marked contrast to the pre-war period, the Grossbanken have joined with the private bankers and numerous public institutions in the task of financial reconstruction. The private banks which have been the intermediaries through which most of the foreign loans have been placed have profited by these operations.

BANKING METHODS AND POLICIES

In view of the important rôle which the credit banks have played in German business life, it was naturally impossible and undesirable to present the preceding exposition without throwing some side lights upon their activities. Consequently a good many of the characteristic features of credit banking have been mentioned in passing. As noted, the development of the German banking system has called forth a vast mass of literature which consists in part of masterly exposition and in part of polemical writings. The nature and the purpose of the German credit banks were the subject of heated controversy especially in pre-war times, and during the period when concentration was in progress. A thorough description of the many types of ac-

tivity peculiar to these banks would undoubtedly exceed the scope of this study. A systematic exposition, according to the approved scheme of studying the active operations and the liabilities incurred, must therefore be omitted. The outstanding work dealing with this subject, Riesser's *Die Deutschen Grossbanken und ihre Konzentration* has already been referred to. There is even less opportunity to enter upon any discussion of controversial matters. The developments of recent years have, as repeatedly mentioned, made it necessary to recognize that the position of the Grossbanken has been weakened and as a result, the fear that they would eventually dominate the entire industrial life of Germany (a danger frequently expressed before the war) is seen to be absurd and has ceased to be expressed. In the following discussion attention will be paid chiefly to the characteristic features of the German credit system and the differences between it and the system that prevails in Anglo-Saxon countries. Here belong such topics as

(1) The relation of the banks to industry and its consequences (reorganization and promotion of new companies, issue of industrial bonds, etc.)
(2) The concentration movement and the relations between the Grossbanken, the medium-sized banks and the private banks.
(3) The restriction of the sphere of activity of the credit banks through public credit institutions and coöperatives and the segregation of land mortgage credit.
(4) Foreign business which was almost destroyed by the war.
(5) Dealings in securities which, as a result of the close relation of the banks to industry and their ownership of large amounts of securities, provide a very important source of income.

Other business operations, especially the acceptance business and of course the extremely important current account business of the German banks, cannot be comprehensively described. In any case there are no great differences observable from the systems in operation in other countries.

(1) Relation of German Banks to Industry. The Grossbanken have again and again been reproached for their practice of " pumping " funds entrusted to them too exclusively into industry and trade and into the Bourse. In fact, every German Grossbank carries in its balance sheet a surprisingly large total of consortial participations when judged by western standards. They likewise hold large amounts of securities for their own account. Moreover, apart from share holdings growing out of credit grants, etc., the connection of the leading German banks with industrial undertakings is notoriously close. This fact finds visible expression in the composition of the boards of industrial establishments on the one hand and the Grossbanken themselves on the other.

An impartial survey of the course of German economic development since 1848 leads to the conclusion that the relation of the German Grossbanken to industry has been an inevitable outcome of general conditions. The Grossbanken have been prevented from having any influence upon agriculture by virtue of the presence of the Landschaften and a host of similar institutions. Then too, innumerable obstacles resting upon social prejudices and political disaffection have been encountered. A still more important reason why the joint stock banks were forced to concentrate their efforts almost exclusively upon industry lies in the fact that the field of mortgage credits was closed to them [9] (with the exception of a few " mixed " mortgage banks). There was in addition an understandable disinclination on the part of the mortgage banks to lend against industrial real estate, as such loans, judged from the point of view of their " real " value solely, were naturally much more of a risk than mortgages upon other city or even country properties. Finally, through the development of the coöperative system, the joint stock banks were to a certain extent excluded from the sphere of the small commercial and trading enterprises. It should, however, be said here that more liberal financing by the joint stock banks in this field would have made the coöperative system less necessary, so that the development of the latter may be said to have taken place because of the policy pursued by the banks instead of in opposition to that policy.

Most of the points mentioned lead back to a consideration of the origins of the German joint stock banking system. The need

[9] See (3) on p. 703.

for joint stock banks grew out of the fact that the German people from the middle of the nineteenth century, because of an increase of population enormous for European countries, were compelled to turn from agriculture to industry. And conversely it was only because of the existence of these banks that the industrialization of Germany could occur at the rate it did. Generally speaking, the German banks occupy a relation to industry midway between the English system and those systems peculiar to the majority of eastern and of financially weaker states. The banks located within the boundaries of the old Austro-Hungarian monarchy offer especially good illustrations of the last-mentioned type of institutions. With its industrialization process spread over a much longer period of time, English industry was able to provide itself with much more capital than Germany could acquire. Quite generally, too, the greater wealth of the population was an advantage for its industry, into which flowed the funds provided by the direct investment of the working classes — a process that in America has recently acquired great significance. Such investments were and still are altogether unknown in Germany. Another consequence of the reduced wealth of the people is evidenced in the fact that German banks (more especially the Austro-Hungarian) have to convert their short-term deposits much more than do the English banks into long-term credits.

Since the deposit funds of the German banks did not represent deposits in the real sense but were the short-time investments of the current accounts of customers, the gulf between the long-term investment needs of industry and the short-term funds flowing into the banks steadily widened. The first form of relief came through the issue of industrial bonds but these, due to the preference of the German capitalist for public securities and above all for mortgage bonds, could not find a market large enough to cover capital needs. The chief burden of financing the highly progressive industrial development fell therefore directly upon the credit banks. Their intermediate position between the English banks and those of financially weaker countries showed itself in the fact that the German banks did not go so far toward providing industry with funds by issue of their own long-term obligations as, for example, did the banks of Austria and Switzerland through their issues of treasury notes. One consequence of this closeness of

relation between the joint stock banks and industry was the establishment of certain special banks which had for their sole objective the advancement of particular industries as, for instance, various mining and electrical banks or the still more specialized Bank fuer Brauindustrie of Dresden — primarily a holding company for brewery shares which at the same time undertook the financing of these enterprises.[10] For years their close relation to industry provided the German banks with the most important sources of income they enjoyed, if we include as income, in addition to the business of founding companies and the taking over of their share issues, the corresponding current account and acceptance business.

On the other hand, the obligations which the controlling banks were forced to incur at a time when business was usually at its worst, were a great source of danger. Indeed, it is very remarkable that since the failure of the Leipziger Bank, Germany has been spared any great collapses and that the credit standing of the leading German banks, even at a time of complete public bankruptcy, remained intact.

In the contest which has been waged rather inconspicuously by the banks to obtain control over industry, success in recent years seems to lie with the industrialists. The reason for the stronger position of industry as opposed to the banks may be due in part to the weakened influence of the independent shareholder. Since the war there has been a great growth of " Schutzaktien " (that is, types of share issues designed to afford the management protection against loss of control). Obviously the number of votes controlled is not so decisively determinant of the real power exercised by the banks as is the industrial dependence created by indebtedness. In this connection, mergers sometimes may have had the consequence of enabling the new company to choose between the original controlling banks.

Then, too, there is the further fact that German business requirements have been financed to only a small extent from within, and to an overwhelming degree by foreign loans, placed more by private bankers than by the Grossbanken. This also has con-

[10] In this connection it should be recalled that German economy is not acquainted with investment trusts and that private banks are established in order to meet this purpose.

tributed to strengthening the position of industry in relation to the big banks.

(2) CONCENTRATION, AND RELATION OF THE "GROSSBANKEN" TO OTHER BANKS. The first great business crisis of 1873 marks the beginning of a concentration movement which, in the decades that followed, proceeded unevenly until it has finally led today (1927) to a situation in which almost all the joint stock banks are under the control of the leading Grossbanken. Among the latter are included in addition to the four D-Banken (Deutsche Bank, Disconto-Gesellschaft, Dresdner Bank, Darmstaedter und Nationalbank), the Berliner Handels-Gesellschaft, the Commerz- und Privat-Bank and the Mitteldeutsche Credit-Bank. The D-Banken own many well known provincial institutions, notably the A. Schaaffhausen'schen Bankverein of Cologne, next to the Disconto-Gesellschaft, the oldest German joint stock bank. The community of interest which the Deutsche Bank formed with the Bergisch-Maerkische Bank and the Silesian Bankverein has been already mentioned. The most important combines of a similar sort, so far as they are still in operation, have already been set forth.

CONCENTRATION MOVEMENT. The extent to which concentration has progressed in the German banking system is revealed by the situation at the middle of 1927. The bi-monthly bank statements embrace all the private joint stock banks with the exception of the Berliner Handels-Gesellschaft. There are 79, or 80, if the Berliner Handels-Gesellschaft be included. The public credit institutions and the mortgage banks are of course segregated. Among these eighty joint stock credit banks are seven well known Berlin Grossbanken, namely the Deutsche Bank, Disconto-Gesellschaft, Dresdner Bank, Darmstaedter und Nationalbank, Commerz- und Privat-Bank, Mitteldeutsche Credit-Bank, and Berliner Handels-Gesellschaft with a combined share capital of 549,000,000 R.M. The Reichskredit-Gesellschaft, being a public institution, is not included in this total. Among the larger middle sized banks are included institutions with a capital of at least 10,000,000 R.M. The Bavarian Hypotheken- und Wechselbank does not quite belong in this classification as it is a so-called mixed institution, doing a mortgage business chiefly (share capital 45,000,000 R.M.). Then there is the Bank fuer Textilindustrie

(share capital 22,250,000 R.M.) which is a pure industrial bank of the Blumenstein concern and hence does not belong among the credit banks. Of the other eight middle sized banks four belong to the groups controlled by the D-Banken which hold up to 100% of their shares. The other four are independent. The former include the A. Schaaffhausen'schen Bankverein (share capital 25,000,000 R.M.) a subsidiary of the Disconto-Gesellschaft group; the Rheinische Kreditbank, Mannheim (share capital 24,000,000 R.M.), a subsidiary of the Deutsche Bank " concern "; the Sueddeutsche Disconto-Gesellschaft, Mannheim (share capital 15,-000,000 R.M.), and the Norddeutsche Bank, Hamburg (share capital 12,000,000 R.M.) both subsidiaries of the Disconto-Gesellschaft " Konzern " (together 76,000,000 R.M.). Thus there remain only four banks with a capital of over 10,000,000 R.M. which are still independent. These are the Allgemeine Deutsche Kreditanstalt in Leipzig (share capital 40,000,000 R.M.), the Barmer Bankverein in Barmen (share capital 36,000,000 R.M.) the Vereinsbank in Hamburg (share capital 15,000,000 R.M.) and the Deutsche Effekten- und Wechselbank in Frankfort-on-the-Main (share capital 10,000,000 R.M.). These four institutions represent a share capital of 101,000,000 R.M.

The other 63 institutions, with share capitals of less than 10,000,000 R.M., control in all capital funds of approximately 130,000,000 R.M., so that on an average the share capital per institution amounts to not more than 2,000,000 R.M. or about $500,000. Among this group are many institutions embraced in the " concerns " controlled by the Grossbanken, but also there are a great number of independent institutions of primarily local importance.

Present Position of the Private Banker. It is hardly necessary to state that the private banking system has in many respects provided the foundations of the present-day structure since the Grossbanken themselves owe their origin to private banking houses. The dominant participation of the leading banking houses in the joint stock banks followed later without a break. At this point, however, mention will be made of only the more or less automatic process of absorption that was effected by the smaller joint stock banks (especially the provincial banks) on the one hand and the Grossbanken on the other. For instance, the

Magdeburger Bankverein in the period from 1905 to 1911 absorbed not less than 11 private banking firms. Despite these direct and indirect absorptions, the number of private banking concerns in 1910 was estimated at 4,000. It must not be forgotten, however, that the German idea of what constitutes a private banking business is much more comprehensive than that of the Anglo-Saxon.

The German small banking business embraces activities which in Anglo-Saxon countries would be called by other names, brokers, bond salesmen, etc. Among these 4,000 banks there would probably not be more than a few dozen that would possess a capital in excess of $1,000,000 even though in the post-war period the private banking business has prospered as already frequently mentioned, especially through the placement of foreign credits and also through the great revenues that security dealings brought in 1926.

Success of Grossbanken in Building up Deposit Business. The attitude of the Grossbanken toward the deposit business had a determinative influence upon the concentration movement. While the older Grossbanken did not pursue the deposit business over energetically, the Deutsche Bank from the beginning adopted a conscious policy with a definite aim. It has already been noted that the majority of the deposit offices and branches of the leading banks created in successive decades were acquired by taking over private banks or smaller joint stock companies. This concentration movement was nevertheless inevitably limited by the fact that in German currency transactions, savings banks, coöperatives, etc., occupy a large field, and these latter institutions through the expansion of their clearing operations have been converted into quite adequate credit organizations. In fact, in spite of the strenuous measures undertaken by the Grossbanken to force progress in this field of deposit business, their successes were, for the reasons given, quite modest. Altogether their deposits amounted in the year 1900 to about 1,000,000,000 marks and by 1910 had risen to approximately 3,250,000,000 marks. The savings banks deposits on the other hand amounted to the sum of 16,000,000,000 marks in 1910 and the deposits of the credit coöperatives (1906) to 2,000,000,000 marks. Account must also be taken of the fact that before the establishment of the sys-

tem of uniform bi-monthly balance sheets, the concept of "deposits" was sometimes confused with current accounts, so that the actual deposits were in all probability even smaller than indicated.

Post-War Depletion of Deposits. The effect which the relatively limited character of the deposit business of the Grossbanken had upon their relation to industry and their opportunities to finance business has been already noted. In the post-war period, as a result of the destruction of savings which had been kept in the form of cash, the deficiency was intensified. That explains, too, why even today the Grossbanken, in financing industries which are not prepared to satisfy the rigorous conditions of a foreign loan, still face a rather difficult and as yet unsolved problem. The attempt which the Deutsche Bank has made to relieve this situation by obtaining a foreign loan, presents a novelty in the history of German banking which has been followed with interest by the entire banking fraternity. This same credit shortage in the case of the medium-sized and small industries has given an incentive to the establishment of Industrieschaften (still in the first stages of development).

(4) The Cultivation of Foreign Fields by the Grossbanken. The systematic cultivation of overseas business was one of the features of the working program taken up by the Deutsche Bank. To be sure, the Darmstaedter Bank had previously made attempts at forming foreign connections. The strong emphasis which the Deutsche Bank placed upon foreign business, however, was only possible after the establishment of the German Empire which resulted in increasing the prestige of Germany abroad. In this respect, therefore, the Deutsche Bank only followed the trend of the times, though in the beginning it was harshly criticized and the bank had to carry on a stubborn fight for the introduction of the mark acceptance in overseas trade in place of the hitherto universal sterling bill. This was only made possible through the creation of an imperial (unified) currency in 1873. As a matter of course, this fight lasted for decades and, when the war came, a point had just been reached at which the mark acceptance in direct transactions with German firms had partially established itself alongside the pound sterling. The developments of the post-war era, it goes without saying, caused the mark acceptance wholly to vanish, and up to the present time there has hardly been oppor-

tunity for its reintroduction. As noted, even the German Gold Discount Bank originally started with a pound currency. As long as the German rate of discount remains above that of the sterling rate, reintroduction of the mark acceptance will be difficult to bring about, quite apart from a certain distrust of the mark as an international currency.

Aside from these technical details, this question has a bearing upon exchange policy and in connection therewith upon the subject of reparations. Without going into the details of this very complicated matter, it must suffice to say that it would be of great advantage to Germany if it could finance its imports of raw materials with mark acceptances, instead of being constantly forced to use bills payable in foreign currencies.

Overseas Affiliated Banks. The pursuit of overseas business by the German Grossbanken was achieved after various attempts (such as share participation) in the decades preceding the war through the establishment of overseas affiliated banks, for example the offshoot of the Deutsche Bank, known as the Deutsche Ueberseeische Bank. Further details are mentioned in connection with the individual "Grossbanken." Practically all these foreign subsidiaries, as well as innumerable companies in the German colonies, were lost through the war. In return the banks acquired only a claim against the Reich for compensation. The most important exceptions are the interests in South America and in Mexico where a partial nationalization of the local branches proved to be necessary. In Europe the strong interests of the German banks in Amsterdam alone are worth mentioning. Of much less importance is the participation in some Austrian banking houses.

(5) The German Banks as Stock Dealers. A number of circumstances have conspired to bring it about that today, as well as before the war, commissions in share dealings constitute one of the most important sources of income of the banks. In the first place this is due to a lack of various intermediaries such as brokers, which has resulted in throwing the entire business of dealing in securities into the hands of the banks. Furthermore, the German "Depotgesetz" as well as the "Boersengesetz" have helped to concentrate this business in the larger institutions.

The Grossbanken, through their industrial concerns, also find

many inducements and opportunities to carry on operations such as controlling quotations, participating in consortiums, etc. In contrast, for instance, to England all German bank shares are fully paid bearer shares and have for years belonged to the class of paper exceptionally well regarded in daily bourse dealings. When purchasing their own shares on commission, the banks are provided with a further source of income. While before the war the German banks in coöperation with the Seehandlung ruled not only the share market but also the money market, this, as often said, is now no longer the case.

DETAILS OF BERLIN GROSSBANKEN

In the following section, some of the most significant data relating to the five Berlin Grossbanken will be assembled (banks listed according to the order of their establishment):

The Disconto-Gesellschaft. The Disconto-Gesellschaft, founded in 1851, was changed into a limited liability joint stock company in 1856. At the date of its establishment it possessed a paid-in capital of 10,000,000 talers, equal to 30,000,000 marks. The most important events in the history of its development are the following: Especial attention given at first to the current account business and the flotation of state and communal loans; active participation in private railways; until 1900, severely centralized management; in 1900, the founding of a branch in London; in 1901, the original Rothschild house in Frankfort-on-the-Main taken over and converted into a branch. Among the many banks absorbed the most important acquisitions are the share capital of 12,000,000 marks of the Norddeutsche Bank in Hamburg in 1895 and the taking over of the A. Schaaffhausen'schen Bankverein A. G. in Cologne (1914). Both banks have since been managed as formally independent establishments. In addition the Disconto-Gesellschaft is influential in the Sueddeutsche Disconto-Gesellschaft A. G. in Mannheim. In 1926 the Bank fuer Thueringen, previously known as B. M. Strupp, A. G., was acquired, with consequent additions to the existing network of branches. The branches in London, Antwerp and Metz as well as numerous valuable foreign connections were lost because of

the war. The most important of these were the various institutions of the former German colonial empire, interests in the Banca Commerciale Italiana, Banca Generale Romana, Banque Internationale de Bruxelles, the Schantung Railway and Mining Company (Eisenbahn und Bergbau Gesellschaft), the Otavi Eisenbahn Gesellschaft and the General Mining and Finance Corporation. As a member of the Austrian Rothschild consortium the Bank was also actively engaged in the issue of east European shares. Excepting the Deutsche Bank, the Disconto-Gesellschaft was the most vigorous in pursuit of foreign business. Among the many pre-war establishments, the ones that acquired permanent importance are the Brasilianische Bank fuer Deutschland, founded in 1887, now known as the Banco Brasileiro Alemao in Rio de Janeiro with a capital of 20,000,000 milreis. In 1895 the Bank fuer Chile und Deutschland, now the Banco de Chile y Alemania, was established in Valparaiso with a capital of 10,000,000 pesos. The founding of the Handel-Maatschappij Albert de Bary and Co. in Antwerp, which was transferred to Amsterdam after the war, was especially important (capital 9,000,000 florins). Through this connection valuable relationships were maintained with the house of Ernesto Tornquist and Co. in Buenos Aires. There remain to be noted the interests of the Disconto-Gesellschaft in a bank in Sofia and in the banking house of Ephrussi and Co. in Vienna. The institution also maintains its own independent representation in New York. The number of employees totaled 7551 in 1927.

In its gold balance sheet the Disconto-Gesellschaft showed a capital of 100,000,000 R.M. as well as reserves of 35,000,000 R.M. Its paper mark capital of 900,000,000 marks, including preferred shares, was converted into gold at the rate of 20 to 3. Since then the bank has increased its capital by 35,000,000 R.M., a part of which sum was taken over by Dillon, Read and Company, New York. Among the industrial interests of the Disconto-Gesellschaft the following may be mentioned: Gelsenkirchener Bergswerk A. G. (one of the parent concerns of the Vereinigte Stahlwerke) (United Steel Works); Kaliwerke Aschersleben, Hamburg-Amerikanische Packetfahrts A. G. (Hamburg American Line), the Stumm Concern, Ludwig Loewe and Co. A. G., Gesellschaft fuer Elektrische Unternehmungen.

Darmstaedter und Nationalbank. The present Darmstaedter und Nationalbank, a limited liability joint stock company, grew out of the former Bank fuer Handel und Industrie and the Nationalbank fuer Deutschland. The Bank fuer Handel und Industrie, founded in 1853, started with a capital of 42,750,000 marks of which only 17,000,000 marks was issued. At that time the institution was to a certain extent under the influence of the system of industrial promoting banks of which the Credit Mobilier was a type. Moreover, it also dealt in state and other security issues although in lesser degree than the Disconto-Gesellschaft. It was characteristic that from the first the bank participated in the businesses it established through its large share holdings. As with other German Grossbanken, the bank until 1870 took a somewhat hesitant attitude toward current account and deposit business. It founded deposit agencies (Depositenkassen) in 1900 — that is much later than the other banks. From the first, dealings in foreign exchange were characteristic and the Frankfort branch established in 1854 gave strong encouragement to this business. In sharp contrast to the original hesitation in setting up deposit offices at home the bank made many endeavors to found foreign companies. The hesitancy about establishing branches and depositories has however been entirely overcome. Today the Bank has no less than 97 depositories and 115 branches in Germany. The line of development taken was furthered by the fact that the Darmstaedter und Nationalbank had been strongly influenced by the personality of one of its heads, Jakob Goldschmidt, and in recent years outstripped all the other banks in its operations on the stock market. This naturally had the effect of increasing the business done on commission. Among the many affiliated companies which the institution established abroad are the Amsterdamsche Bank (1871) and the Ungarische Escompte- und Wechslerbank (1877). It also participated in the founding of the Banque Internationale de Bruxelles. In Vienna it has a controlling influence in the Merkurbank. Among the other permanent affiliations are the Internationale Bank te Amsterdam; the Deutsch-Suedamerikanische Bank; the Deutsche Orientbank and the Danziger Bank fuer Handel und Industrie. The chief importance of the Darmstaedter und Nationalbank lies today in its

influence in the industrial field. This has been greatly strengthened by the successes of recent years, such as the reorganization of the Stinnes "Konzern" and shipping combination. On its board of directors the following industries are represented: Linke-Hofmann-Lauchhammer, Norddeutsche Wollkaemmerei und Kammgarnspinnerei, Gold- und Silberscheideanstalt, Bismarckhuette, Schultheiss-Patzenhofer Brauerei A. G. and Norddeutscher Lloyd, besides the Muenchener Rueckversicherungs A. G. The employees of the institution number 7293.

The gold balance sheet of the Darmstaedter und Nationalbank shows a capital of 60,000,000 R.M. and reserves of not less than 40,000,000 R.M. The conversion of the paper mark capital of the two fused institutions was effected in the ratio of 10 to 1. The capital which has not been increased since the gold conversion appears exceptionally small in relation to the pre-war capitals of the two united banks. At the end of 1914, for example, the capital of the Bank fuer Handel und Industrie amounted to 160,000,000 marks (reserves 32,000,000 marks) and the capital of the Nationalbank fuer Deutschland was 90,000,000 marks (reserves 8,000,000 marks).

Berliner Handels-Gesellschaft. The Berliner Handels-Gesellschaft was founded in 1856 with a capital of 45,000,000 marks of which only 11,220,450 marks was issued. Its chief strength lay from the beginning in the field of issuing and placing securities, state bonds, railways loans, Russian issues. For a very long time the institution remained aloof from the current account and deposit business and even today it is the only one among the Berlin Grossbanken that has remained true to the principle of strict centralization possessing neither branches nor depositories. In the opening decades of its existence it was rather hard hit by industrial losses and this necessitated, in 1882, a reduction of it original capital from 30,000,000 marks to 20,000,000 marks. From that time forward, however, the Bank made unbroken progress under the brilliant leadership associated with the name of Carl Fuerstenberg. From 1883 until the outbreak of the war the average dividends amounted to $8\frac{1}{2}\%$. In the pre-war period the capital had already reached 110,000,000 marks and the reserves 43,500,000 marks. In conspicuous contrast to the policy

pursued by other banks, the Handels-Gesellschaft clung to this 110,000,000 marks with the result that its shares acquired a reputation during the years of inflation because they were among the very small number of unwatered stocks. The return to gold balances brought an unexpectedly sharp reduction of the pre-war capital to 22,000,000 R.M., a ratio of 5 to 1, with only 5,000,000 R.M. in reserves. Public opinion at once jumped to the conclusion that here again the well-known conservative management of the Berliner Handels-Gesellschaft had counseled excessive caution and, consequently, ever since the gold conversion, the quotation of the shares has remained above that of the shares of other German banks.

A characteristic indication of the unique position which the Berliner Handels-Gesellschaft occupies among the Grossbanken is the circumstance that it is the only joint stock commercial bank which has until now failed to publish a bi-monthly statement. The only compulsion exercised to induce publication of these statements lies in the fact that the committee on admissions (Zulassungsstelle) of the Berlin Bourse makes its approval of new issues of bank shares dependent upon such publication by the institution concerned. As a result the Berliner Handels-Gesellschaft has not raised its capital since gold conversion became effective. In that way it has evaded publication of the bi-monthly balances. The Bank takes rank among the other German banks as the bank for industry par excellence, to which all other branches of activity are subordinate. Its position is especially strong in the electrical industry, in the heavy industries and in railways and narrow gauge lines. (Kleinbahnen.) Among its most important connections are numbered the Allgemeine Elektrizitaets-Gesellschaft with its many subordinate companies, as for example the Bank fuer Elektrische Unternehmungen, Zuerich 1897, the Elektrische Lieferungs-Gesellschaft, Berliner Elektrizitaetswerke, the Aluminium Industrie Aktien-Gesellschaft, Neuhausen. One of the largest of the subsidiary companies, the Deutsch-Ueberseeische Elektrizitaets-Gesellschaft, because of the war had to be changed into a foreign company — the Companhia Hispano Americano de Electricidad (Chade). It has since made brilliant progress.

Of its connections with the heavy industries the Harpener Bergbau Gesellschaft may be mentioned. Among the numerous interests in railways and narrow gauge lines, the Aktien-Gesellschaft Verkehrswesen stands out prominently. In consequence of its connection with the A.E.G., the bank participates in the foreign field in all the German telegraph companies, the two Schantung companies, etc. Among the foreign banks established by it are the Banque Internationale de Bruxelles, and the Banca Marmorosch Blank et Cie, in Bucharest. Its board includes representatives of the following industries: A.E.G., Allgemeine Elektrizitaets-Gesellschaft), Oberschlesische Kokswerke und Chemische Fabrik A.G., Berliner Maschinenbau A.G., formerly L. Schwarzkopf, Caro-Hegenscheidt, Deutsche Continental Gas Gesellschaft, Deutsche Eisenhandels A. G., Metallgesellschaft, Harpener Bergbau A. G., Rombacher Huettenwerke, Vulkanwerke, Hamburg und Stettin. There are 615 employees.

The Deutsche Bank. The founding of the Deutsche Bank took place on February 25, 1870. Its capital was fixed at 15,000,000 marks. The principles that guided the bank in its conduct of affairs have been spoken of so often that it is hardly necessary to refer to them again. Through its conscious emphasis upon deposit and foreign business, the Deutsche Bank has contributed greatly to the development of the German commercial banking system as it stands today. Founded during one of the most fortunate periods in the history of the German people, the Deutsche Bank has had an unbroken history of progress. An outstanding event in its history and in that of German banking as a whole was the already mentioned formation of a community of interest with the Bergisch-Maerkische Bank and with the Silesian Bankverein in 1897. The former institution was definitely taken over in 1914 and the latter in 1917. In 1906 an interest was acquired in the Wuerttembergische Vereinsbank in Stuttgart which has since also been absorbed by the Deutsche Bank. In this respect the Bank stands in complete opposition to the Disconto-Gesellschaft which permits the larger of the banks which it acquires to remain formally independent. In 1922 the Deutsche Bank acquired the Deutsche Petroleum A. G., giving its own

shares in exchange. In 1925 it acquired the Essener Creditanstalt in Essen.

Hand in hand with this concentration movement the number of branches increased. Today the Deutsche Bank possesses 176 extensions. Among them 101 city depositories are maintained, of which 37 are located in Berlin. The bank has branches abroad in Amsterdam, Danzig, Kattowitz, Constantinople and Sofia. The branches in London and Brussels were lost through the war. Among the overseas establishments, apart from the colonial establishments, are the Deutsche Ueberseeische Bank and the Deutsch-Asiatische Bank in Shanghai. After the war the latter institution was again able to take up operations. Among other foreign creations are the Banca Commerciale Italiana and Banque Internationale de Bruxelles. The Deutsche Bank was and is in respect to the scope of its business activities (current accounts, deposit business and especially foreign business) the greatest of the German banks. From the circle of institutions that stand in close connection with the Deutsche Bank the following are represented on its board of directors: Siemens Konzern, Mannesmann Roehrenwerke, Borsig Maschinenbau A. G., Phoenix A. G., Haniel Konzern, Deutsch-Australische Dampfschiffahrts-Gesellschaft (Kosmos), Norddeutscher Lloyd, Hirsch Kupfer-und Messingwerke, Sueddeutsche Zuckerindustrie, Rheinische A. G. fuer Braunkohlen-Bergbau, Gesellschaft fuer Hoch- und Untergrundbahnen and others. The Deutsche Bank formerly participated in dominant fashion in the Oriental Railways, the managing company for the Betriebsgesellschaft fuer Orientalische Eisenbahnen, and also in the Anatolian railway.

The number of employees of the institution totals approximately 16,000.

The gold balance sheet of the Deutsche Bank showed a capital of 150,000,000 R.M. and reserves of 50,000,000 R.M. The conversion of the paper mark capital into gold took place in the proportion of 10 to 1. At the same time 40,000,000 R.M. of preferred stock was placed in America but in 1926 it was brought back and distributed among the domestic shareholders in the proportion of 3 to 1 at 150.

The Dresdner Bank was founded in 1872 with a basic capi-

tal of 24,000,000 marks of which 9,600,000 marks was paid in. Like the Bank fuer Handel und Industrie, the center was shifted from Dresden to Berlin in 1881. In its cultivation of the deposit business, the Dresdner Bank has followed closely at the heels of the Deutsche Bank and has in fact as regards the all-around character of its development perhaps surpassed the Deutsche Bank. After first absorbing a number of smaller institutions, the bank began in 1892 to extend its activities to embrace larger enterprises.

Temporarily it formed a community of interest with the A. Schaaffhausen'schen Bankverein now belonging to the Disconto-Gesellschaft.

Today the bank possesses 87 branch establishments and 55 depositories. The number of employees totals 8622. The creation of a coöperative section in Berlin and Frankfort-on-the-Main was of especial importance for the institution since it serves as a central agency for the so-called Giroverband of the Dresdner Bank to which about 1,000 of the larger credit coöperatives are at present attached. This development partially accounts for the already mentioned constant increase of current business. The foreign business of the bank dates only from 1892. A branch was established in London in 1901 which was lost through the war, as was its connection (the only one among the German banks) with a Parisian banking house, Allard et Cie. Numbered among the overseas affiliations are the Deutsch-Suedamerikanische Bank, and the Deutsche Orientbank (the latter lost through the war all its Egyptian and Turkish branches which however have since resumed operations). In Amsterdam the Bank established after the war a limited liability company under the firm name of Proehl and Gutmann.

The Bank is also interested through share holdings in the International Bank in Luxemberg. In connection with foreign undertakings, the Dresdner Bank together with the Deutsche Bank participated in the Anatolian Railway Company, the Bank fuer Orientalische Eisenbahnen, the various Schantung companies, etc. From the first the Dresdner Bank has done an active business in securities. The " Konzern " is interested among others in Ludwig Loewe A. G., Scheidemandel, Kattowitzer A. G. fuer Bergbau-und Eisenhuettenbetrieb. While the Dresdner Bank

therefore excels almost all other banks in its deposit business, security dealings, trade credits, etc., it is behind the Deutsche Bank and the Disconto-Gesellschaft, perhaps even behind the other Grossbanken, in respect to its foreign business.

The Bank's gold balance sheet shows a capital of 78,000,000 R.M. and reserves to the amount of 22,000,000 R.M. The paper mark capital was converted into gold at the rate of 12½ to 1. Since then the institution has raised its capital to 100,000,000 R.M. The shares were offered to existing holders at the rate of 120.

CONCLUSIONS

In Germany, more perhaps than in any other country, the years of inflation put a great gulf between the period beginning with the year 1924 and the earlier normal pre-war era. For purposes of comparison, 1913 is usually selected as a starting point since by 1914 the war had already introduced great confusion. Two features in particular differentiate the German monetary system since 1924 from that of the pre-war period. First of all there are the obligations assumed under the Dawes Plan and then there is the fact that Germany, from having been overwhelmingly a creditor land, has become a debtor country forced to obtain the capital required by her private industries through foreign loans. In this connection America plays the decisive rôle not only directly as the most important creditor in the placement of German foreign loans, but indirectly through the debt settlements made with her Allies. As long as the Dawes annuities and the interest on the foreign loans have to be paid with bills of exchange (giving rise to the so-called transfer problem) the German monetary system will have to acknowledge a dependence upon other countries which did not exist before the war.

Herein lies the explanation of the great influence which the Reichsbank exerts upon the German monetary system — incomparably greater than before the war. The energetic management of the Reichsbank has furthermore brought into greater or less subjection to it, a circle of institutions which have become pillars of strength in the domestic money market (Gold Discount Bank, Rentenbank-Kredit-Anstalt, etc.)

As a result of the extraordinary powers conferred and the tasks imposed in war-time, as well as in consequence, of the various social reform plans that immediately followed the Revolution, and other influences, a tremendous impulse was given to coöperative effort which has made great strides in the monetary field.

The growth of public credit institutions, too, has been noticeable in many lines of endeavor. One of the most important and enduring of these new developments is the extension of the system of Girozentralen (clearing centers). Many of the varied activities of public bodies in the banking business have still to assert themselves. The tendency to draw into a unified central organization various types of credit institutions is unmistakable (for example Landschaften-Zentrallandschaft, Landesbanken-Landesbankzentralen). Such a unification was made all the more necessary by the fact that it greatly facilitated the placement of loans abroad. The private mortgage banks lost their chief customers for mortgage bonds during the years of inflation that dissipated domestic savings, and found themselves compelled to follow the general example and make stronger appeals to foreign markets than ever before.

In the preceding decades the typical " mixed " system of credit banks had withstood the acid test and had survived. The German credit bank had assumed definite shape. The combination movement, a common phrase which had more significance during the years from 1890 to 1910, continued without cessation (for example the fusion of the Darmstaedter Bank with the Nationalbank fuer Deutschland in 1922). The absorption of local financial institutions however appears to be about completed. In this field the Grossbanken and their branches constantly come into contact with the coöperative credit organizations and with the savings institutions which have been vastly strengthened by the Girozentralen.

The extension of the system of deposit offices (Depositenkassen) of the Berlin Grossbanken falls in this period. The monetary transactions of the entire Reich are increasingly concentrated in Berlin.

The financing of the medium-sized and smaller industries remains a task for the future. Among other expedients, a so-

lution is being attempted by the establishment of Industrieschaften.

Since the creation of the rentenmark and the acceptance of the Dawes Plan, the German people have again felt as if they stood upon a firm foundation and they have gone untiringly to work to reconstruct an industrial system that had fallen into ruins.

CHAPTER IX

THE BANKING SYSTEM OF HOLLAND

BY

A. M. de Jong

THE MONETARY SYSTEM

Pre-War Monetary System. The monetary system of the Netherlands has varied largely during the first three quarters of the nineteenth century. From 1816 to 1847 bi-metallism prevailed in Holland, but for reasons which it would take too long to explain in the present survey, this system was found unsatisfactory, and in 1847 the law was altered, gold was demonetized, and the silver standard was adopted. Under the prevailing circumstances this was probably a wise measure; and for a good while the silver standard worked very well. But the fall in the value of silver which set in in the early seventies put an end to it. In 1873 the free coinage of silver had to be suspended, and for somewhat more than two years Holland had no metallic standard at all. By the act of June 6, 1875, however, a new gold coin was introduced. This coin was made legal tender to any amount, and it was provided that everyone possessing gold bullion, should be entitled to present it at the National Mint and have it converted (at a small charge) into coin. At the same time the larger silver coins were left unlimited legal tender, as they had been under the régime of the silver standard.

Coinage Act of 1901. Since 1875 the monetary system has on principle remained the same. In 1901 the different laws on the subject were codified into the Coinage Act of 1901, which is still in force. According to this act, as amended on a few points of secondary importance by subsequent acts, the currency unit is the guilder (or florin) of 100 cents. The metallic currency of the country consists of —

a. Coins which are legal tender to any amount, namely (1)

gold: the pieces of 10 guilders and 5 guilders; and (2) silver: the pieces of 2½ guilders (*rÿksdaalders*), 1 guilder, and one-half of 1 guilder.

b. Coins which are legal tender to a limited amount, namely (1) silver: the pieces of 25 cents and 10 cents; (2) nickel: the piece of 5 cents; and (3) bronze: the pieces of 2½ cents, 1 cent and one-half of 1 cent.

The weight of the pieces of 10 guilders and 5 guilders is 6.72 grams and 3.36 grams, respectively; both contain gold 0.900 fine. The weight of the silver *rÿksdaalders,* guilders and half-guilders is 25, 10, and 5 grams respectively; they were coined before the war at the rate of 0.945 fine.

Rôle of Bank Notes. In addition to the metallic currency, bank notes play a very important part in the monetary system of the Netherlands. They are issued by the Netherlands Bank (the only bank of issue in the country) in denominations of 10, 20, 25, 40, 60, 100, 200, 300, and 1000 guilders, and are legal tender to any amount except as regards payments by the Netherlands Bank itself. The Bank is obliged to redeem them, if so required, in other legal tender currency. The Netherlands Bank is bound by law to keep a metallic reserve against all its liabilities payable on demand, which include bank notes in circulation as well as deposits. The minimum of this reserve is fixed by royal decree and amounted before the war to 40 per cent of the total of demand liabilities.

Types of Money in Circulation. As to the actual amounts of money in circulation, it should be mentioned that gold coins did not circulate before the war, and do not circulate now, in the Netherlands, to any appreciable extent, the gold reserves of the country being concentrated, as will be further explained below, in the vaults of the Netherlands Bank. The circulation of silver, nickel and bronze currency was estimated in January, 1914, to be approximately Fl. 65,000,000. The circulation of bank notes amounted in July, 1914, to Fl. 322,000,000 (monthly average).

The Gold Exchange Standard. Although Dutch law does not contain any such clause as section 1 of the United States act of March 14, 1900, there can be no doubt that from 1875 until the outbreak of war in 1914 the Netherlands have been on the gold standard, and, more particularly, on the gold exchange stand-

ard. It should be clearly understood, however, that this is only partly due to the act of June 6, 1875, just mentioned. This act, by allowing the free coinage of gold, made it impossible for the value of the Dutch currency unit to rise for periods of any importance appreciably *above* the value of 0.6048 grams of fine gold (0.672 grams 0.900 fine); but it did not guarantee that the value of the guilder would not fall *below* the value of 0.6048 grams of fine gold. That, nevertheless, the Netherlands may rightly be said to have been on the gold standard up to 1914, is entirely due to the policy of the Netherlands Bank. For as soon as the act of 1875 had come into force, the Netherlands Bank made it its fixed rule, whenever the foreign exchanges reached the upper specie point — thus showing that the value of the Dutch currency unit was beginning to decline as against the value of gold — to deliver gold for export on the basis of the mint price (Fl. 1653.44 per kilo fine) and without charging any premium whatsoever. The effect of this policy in such cases was to reduce the volume of money in circulation and thus to raise the purchasing power of the guilder.

Restriction in Use of Gold for Domestic Circulation. In order to be always able to deliver gold for export, the Bank made it its policy to restrict the issue of gold for home circulation to a minimum. The Bank could easily do this, because there was no clause in the law prescribing that it should pay its notes in *gold*. The Bank was only bound to pay them, if so required, in *legal tender;* and the larger silver coins were legal tender just as well as the gold coins. At the same time, the Bank was always ready, although it was not obliged by law to do so, to buy gold at a fixed price, originally of Fl. 1645 and since 1881 of Fl. 1648 per kilo fine. As the latter price was somewhat more advantageous for the seller of the gold than what he was able to obtain at the National Mint,[1] all the gold that came to the Netherlands when the exchanges gave occasion to gold imports, used to find its way into the vaults of the Netherlands Bank — the clause in the Coinage Act regarding the free coinage of gold thus being practically

[1] One kilo of fine gold, coined into ten-guilder-pieces, represents a value of Fl. 1653.44. The minting charge is Fl. 5.55 per kilo fine, which leaves Fl. 1647.89. Moreover, as the minting naturally takes a certain time, allowance has to be made for loss of interest.

made a dead letter for all parties other than the Netherlands Bank itself.

Foreign Bill Policy. After having obtained, according to an act of 1888, the right to purchase and sell foreign bills, the Bank from the beginning of the nineties began taking steps far in advance of those taken before. As soon as a demand for remittances to foreign countries made itself felt to such a degree as to raise the exchanges, without, however, immediately bringing them up to the gold export point, the Bank began to sell, as far as was within its power, checks on foreign countries. In this way it was often able to correct temporarily adverse exchanges, without being obliged to deliver gold for export. It is clear that, in order to be in a position to sell checks on foreign countries, the Bank had to hold assets abroad. Part of these assets was held in the form of balances with foreign correspondents, but the bulk of them used to be invested by the Bank in foreign bills, which, in case of necessity, could be immediately converted into such balances by rediscounting.

On account of the peculiar features of the Dutch monetary system, mentioned in the two preceding paragraphs, viz. (1) the almost complete concentration of the country's gold stock in the vaults of the Netherlands Bank and since the early nineties also (2) the practice of the Netherlands Bank in maintaining the gold parity of the guilder partly by selling checks on foreign centers, the species of gold standard prevailing in the Netherlands before the war, is usually styled the *gold exchange standard.* For a proper understanding of the system it should be added that the whole of the policy of the Netherlands Bank briefly described above, was entirely based on tradition and not prescribed by law. The Bank did, however, in the year 1903, make a formal statement to the Government, in which it undertook " to maintain and continue the gold policy hitherto pursued by the Bank, by continuing to keep its gold stock available for export, as far as lies within its power, on the basis of Fl. 1653.44 per kilo fine for bullion, and at corresponding prices for gold specie, whenever the foreign exchanges should rise above gold parity."

Embargo on Gold Exports During and After the War. Although Holland remained neutral during the whole of the war, the outbreak of hostilities in 1914 caused grave disturbances, and

a feeling of extreme uncertainty as regards the future, in the Netherlands money market. In these circumstances it was thought essential to protect, as far as possible, the gold reserves of the country. To this end the export of gold from the Netherlands, except under special licence to be granted by the Government, was prohibited by a royal decree of July 31, 1914, confirmed a few days later by an act of August 3. This embargo on the export of gold made it impossible for the Netherlands Bank to continue its well-tried policy of maintaining the gold parity of the guilder, and accordingly the Bank was formally released by the Government from the obligation which it had undertaken in its statement of 1903 above referred to. It is clear that this meant the abandonment of the gold standard. The situation thus created remained unaltered until the spring of 1925. On April 28 of that year the Netherlands Minister of Finance made a statement in the Dutch Parliament to the effect that, from April 29, 1925, the embargo on the export of gold would no longer be operative, and that, in connection therewith, the Netherlands Bank undertook, from that date, to carry out again the policy announced in its declaration of 1903. In this way, after an interval of nearly eleven years, the gold standard was restored in the Netherlands.

Present Gold Policy. It should be added, that, contrary to its pre-war practice, the Netherlands Bank started, in November, 1925, to pay out gold coin for internal circulation. The reason for this measure was to be found in the fact, that, largely as a result of the inflow of gold in the Netherlands during the war, the Bank felt that it was now able, to a certain extent, to meet the demand for ten-guilder gold pieces supposed to exist among the public at that time. Up till now, however, the circulation of gold coins has not assumed great proportions. During the winter of 1925–1926 a total of approximately Fl. 24,000,000 was issued by the Bank for home circulation. But a large part of this sum seems to have been hoarded. In the actual circulation the gold coins are seldom seen, and the general public seems to prefer using bank notes. Since February, 1926, the issue of gold for internal circulation, although it has not been stopped, only takes place on a very moderate scale.

In connection with this policy of issuing gold for home circula-

tion the Bank has reduced its buying price for gold from Fl. 1648 to Fl. 1647.50 per kilo fine, because the price of Fl. 1648 did not leave a sufficient margin to the Bank for having the gold converted into Dutch gold coin at the Mint without incurring a loss. As, however, the new price will as a rule be still somewhat more advantageous for the seller than what he can obtain at the Mint (on account of the loss of interest involved in having gold minted), this measure does not make any material difference in the Bank's gold policy.

Reduction in Required Metallic Cover — 1914. In order to enable the Netherlands Bank to meet more efficiently the monetary crisis of July and August, 1914, it was deemed desirable to increase the Bank's lending power. To this end the minimum of the metallic cover to be held by the Bank against its demand liabilities, was reduced from 40 per cent. to 20 per cent. by another royal decree of July 31, 1914. This decree is still in force. But the actual percentage of the reserve has been less than 40 only during the first few months of the war. Since about the middle of December, 1914, the proportion of the actual metallic cover has always been above and often very substantially above this figure. At present (August, 1926) it amounts to about 50 per cent.

Suspension of Redemption. With a view to the possibility that Holland might be involved in the war, an act of August 3, 1914, authorized the Government to exempt the Netherlands Bank from its obligation to redeem its notes as defined in its charter. It has not been necessary, however, for the Government to make use of this power.

Hoarding of Silver Coins. Among the effects of the financial disturbance caused in the Netherlands by the outbreak of war, was a general tendency to hoard silver coins. This tendency assumed such proportions that during the first few days of August, 1914, practically all the larger silver coins disappeared from circulation, and an urgent need of means of payment below the amount of ten guilders made itself felt. In order to provide for this need the Government was authorized by an act of August 6, 1914, to issue currency notes (usually called *zilverbons* — "silver notes") to a maximum total of Fl. 25,000,000. This figure was raised during and immediately after the war by three subsequent

acts to Fl. 40,000,000, Fl. 60,000,000 and Fl. 100,000,000 respectively. The " silver notes " are unlimited legal tender and were originally issued in denominations of 1, 2½, and 5 guilders. The amount of currency of this type in circulation attained its maximum at the end of 1918 when a little over Fl. 70,000,000 in " silver notes " were outstanding. It has diminished since then to about Fl. 14,000,000 at present. The only " silver notes " in circulation are now practically those of 2½ guilders. The 5-guilder notes were never very popular and have long disappeared, while most of the 1-guilder notes have been gradually withdrawn during the last few years.

Reduction in Fineness of Silver Coins. Owing to the considerable rise in the price of silver which took place during and immediately after the war, the metallic value of the larger silver coins in the course of 1919 became greater than their face value. With a view to this fact an act was passed on November 27, 1919, reducing the fineness of the pieces of 2½ guilders, 1 guilder and one-half of 1 guilder, thereafter to be minted, from 0.945 to 0.720. It was, however, not until the year 1922 that a beginning was made in the minting of coins (for the time being only 1-guilder pieces) of the new fineness. Up to the present (August, 1926) about Fl. 20,000,000 of these new coins have been struck. They were chiefly made of 2½-guilder pieces of the fineness 0.945, which were withdrawn from circulation and melted down for that purpose.

Types of Money Circulating at Present. For the sake of completeness it should be mentioned that during the war considerable amounts of new silver guilders and smaller coins have been issued in the Netherlands. As a result, the circulation of hard currency is substantially larger now than it was in 1914. According to the latest annual report of the National Mint the total of silver, nickel and bronze coins in circulation on January 1, 1926, should have amounted to approximately Fl. 102,000,000. This figure, however, does not allow for the coins fraudulently melted down and exported during and after the war, concerning which no reliable data are available. The circulation of bank notes amounted in January, 1926, to Fl. 871,000,000 (monthly average).

THE CENTRAL BANK

Legal Organization. The Central Bank of Holland is the Netherlands Bank (*De Nederlandsche Bank*), already referred to in the previous pages. It was founded in 1814, when a royal charter was granted to the Bank for a period of 25 years. This charter has been subsequently renewed by a royal decree of August 21, 1838, and by an act of December 22, 1863. By virtue of this act, as amended by the acts of August 7, 1888, December 31, 1903, August 3, 1914, and July 25, 1918, and subject to the provisions therein contained, the Bank is entitled to act as a bank of issue up to March 31, 1934. After the expiration of this term the Bank's charter shall be considered to have been extended for an unlimited number of periods of one year each until notice to the contrary be given either by the Government or by the Bank. As already stated above, the Netherlands Bank is the sole bank of issue in the Netherlands. The foundation of other banks of issue, although not legally impossible, would require a special act in each separate case, and, as matters now stand, is highly improbable, and practically out of the question.

The Netherlands Bank is a private institution in the form of a limited stock company. Its capital amounts to Fl. 20,000,000 fully paid up. The head office of the Bank is at Amsterdam and the Bank has branch offices and agencies all over the country. At present there are 18 branch offices and 82 agencies. The following provisions of the Bank Act deserve special attention.

Administration of the Bank. The Netherlands Bank is governed by a Managing Board, consisting of a President, a Secretary, and not less than two other members (at present there are three other members). The President and the Secretary are appointed by the Queen for a term of seven years at each appointment. The other members are appointed by the Bank's shareholders for a term of five years at each appointment. The Managing Board is assisted by an Advisory Committee, consisting of five persons, to be appointed by the shareholders; and a Board of Directors (*Commissarissen*), consisting of at least fifteen members, also to be elected by the shareholders, supervises the management of the Bank.

Powers of the Bank. The Netherlands Bank has authority:

(1) to issue bank notes;

(2) to discount bills of exchange, promissory notes, and debenture bonds redeemable within six months;

(3) to grant advances (lombard loans) on stocks and bonds, merchandise, coin and bullion, paper eligible for discount, and foreign bills, checks and telegraphic transfers;

(4) to purchase and sell precious metals;

(5) to purchase and sell bills, checks and telegraphic transfers payable abroad (this power was given to the Bank by the act of August 7, 1888);

(6) to receive deposits in current account from, to provide transfer-(*giro*) and clearing-accommodations to, and to effect the collection of moneys on behalf of its customers;

(7) to take into custody securities and other valuables;

(8) to sell "assignations" (a sort of drafts) on its offices. The Bank is not allowed to perform any transactions other than those just mentioned, unless it be especially authorized to do so by royal decree. It is, consequently, not allowed to buy or own securities (except for the investment of its surplus fund, one fifth part of its share capital, and the pension fund for its staff). It may not own any real estate except its premises. And it is explicitly forbidden to grant any credits or advances whatsoever without collateral.

As to the sort of customers with which it deals, the Bank is entirely free. It may discount paper for, grant advances to, and receive deposits from anyone it wishes to admit as its customer, other banks as well as business firms and private persons. In fact an important part of the lending business, especially as regards the granting of advances, is done with private individuals, and, besides banks, financial, and other business concerns, a good many private persons have an account in the Bank's books.

The Netherlands Bank is bound by law to publish weekly balance sheets. In addition it issues annual reports (in a Dutch and an English edition).

Relations Between the Bank and the Government. (1) The Netherlands Bank acts, free of charge, as fiscal agent to the Netherlands Government, and to certain government institutions like the Post Office Savings Bank.

(2) Upon application of the Minister of Finance the Netherlands Bank is bound to grant advances to the State, free of interest, but not exceeding a total of Fl. 15,000,000.

(3) Whenever the Bank's net annual profits exceed 3½ per cent. of its capital, the State receives a share in these profits. This share amounts to three-fourths of the profits as long as the dividend to be paid by the Bank does not exceed 7 per cent. Of the then remaining profits the State receives seven-eighths.

(4) A royal commissioner, to be appointed by the Queen, supervises the Bank's transactions.

The Bank Act provides that the State shall no longer be entitled to claim any share in the Netherlands Bank's profits:

(a) if any body other than the Netherlands Bank should at any time be allowed to issue bank notes; and

(b) if the State should resolve to issue currency notes.

In the latter case the State also forfeits its right to the advances mentioned under (2). In view of the extraordinary conditions which gave rise to the issue of " silver notes " at the outbreak of war, it was stipulated at that time that the " silver notes " should not be considered currency notes in the sense of the Bank Act.

Note Issue and Metallic Reserve. The main regulations regarding the note issue of the Netherlands Bank have already been dealt with in the previous section.[2] For a proper understanding of the subject it should be mentioned that, apart from the stipulation concerning the metallic cover of the Bank's demand liabilities, the total amount of the note issue is not subject to any legal restriction whatsoever. There is no legal maximum for the note circulation as in France, and the Netherlands Bank is not bound, as the German *Reichsbank* is, to hold a cover in bills against that part of its note issue which is not covered by metal. On the other hand, the Netherlands Bank's foreign bill portfolio is left out of account in the calculation of the metallic cover of the demand liabilities, as prescribed by law. It may be added here that the Netherlands Bank is not allowed to issue notes in denominations smaller than Fl. 10. Apart from this stipulation the Bank is free in fixing the denominations of its

[2] *Vide* pp. 724–725.

notes. By virtue of the Stamp Act the notes are not subject to stamp duties.

Increase in Note Circulation During and After the War. The outstanding feature of the average annual amounts of the Netherlands Bank's note circulation during the period 1875–1926, is, of course, the unprecedented increase in the note issue during and immediately after the war. It should be noted that this increase can only partly be explained by the growth of the Bank's discounts and advances. It is also due (and certainly not to a less important extent) to the large imports of gold into the Netherlands during the years 1915 to 1917 (inclusive), which all found their way to the vaults of the Central Bank. In addition to fluctuations in the average totals of the note circulation, attention should be directed to the average annual data of per capita note circulation. As far as they relate to the last eight or nine years these figures have to be used with a certain reserve, because during the latter part of the war period, and especially in the years immediately following the Armistice, a fairly considerable amount of bank notes was exported and held in foreign countries. On the whole, however, the official data of the note circulation are sufficiently accurate to give an idea of the very important part which bank notes play in the Netherlands. The practice of making payments by check, although it has developed considerably during the last ten or fifteen years, is not by any means as extended in Holland as it is in the English-speaking parts of the world.

Other Demand Liabilities. As has been said already, the metallic reserve of the Netherlands Bank is held not only against the note issue, but against the total of the Bank's liabilities payable on demand. These consist, besides the notes in circulation, of the Bank's deposits and of its " assignations " outstanding. The latter usually do not amount to more than Fl. 1,000,000 or Fl. 2,000,000 and are for our purpose negligible. The deposits (with which we shall deal more fully on a subsequent page) are also of comparatively small importance. In fact the note issue forms by far the largest part of the demand liabilities. During the period under consideration the actual metallic reserve has usually been substantially above its legal minimum. As a rule the average annual percentage was more than 50 and only on one

occasion it fell below 45. This does not mean, however, that the demand liabilities have always been covered to that extent by *gold.* For the Netherlands Bank's metallic reserve is not a pure gold reserve. According to the law it may consist of gold and silver (coin as well as bullion) and partly also of nickel and bronze coins. The nickel and bronze coins have, of course, always played a negligible part. But, as a result of the fact that from 1847 to 1873 the régime of the silver standard prevailed in Holland, the amount of silver coins in the reserve has for a long time been rather considerable. In actual fact, up to 1906, as a rule more than half of the total reserve consisted of silver coins. Since then, however, the situation has completely changed. The amazing economic development of the Dutch East Indies (the monetary system of which is on principle the same as that of the mother country) made the greater part of the Netherlands Bank's silver stock find its way to the colonies. At the same time the gold stock of the Bank increased considerably, and in the beginning of 1909 already more than 70 per cent. of the total metallic reserve consisted of gold. Five years later this figure had increased to a little over 94 per cent., and during the period 1915–1926 the proportion of gold in its reserve has averaged from 97 to 98 per cent.

The Discount Business. We have already seen that the Netherlands Bank has authority to discount bills of exchange, promissory notes, and debenture bonds redeemable within six months. The last four words relate to debenture bonds only. As to the bills and promissory notes to be admitted to discount, the Bank Act provides that they may not have a maturity longer than is in accordance with the customs of trade. In practice the Bank usually does not discount paper having a maturity of more than three and a half months or, in exceptional cases, six months. In order to be eligible for discount, bills as well as promissory notes must bear at least two signatures. Unlike the Federal Reserve Act, the Netherlands Bank Act does not say that, in general, the paper, to be eligible for discount, must arise out of actual commercial transactions; but it has always been the Netherlands Bank's practice to refuse so-called accommodation-paper. At the same time, the Bank is ready, on principle, to discount treasury bills and, subject to certain

restrictions, similar paper of municipalities and other public bodies.

Bills of Exchange. This is perhaps the most suitable place to say a few words about the legal aspects of bills of exchange and promissory notes, which are the two types of credit instruments most widely used in the Netherlands. A bill of exchange is defined by the Dutch Commercial Code as " a document, dated from a place, and by which the signatory requires someone to pay, at a specified place, at or after sight or at a fixed time, a sum of money expressed therein, to, or to the order of, a specified person." It follows from this definition that Dutch law does not admit bills of exchange payable to bearer. A particular form of words is not required for a bill of exchange.

The accepting of bills of exchange is affected where the drawee writes his signature on the face of the bill. The property in a bill of exchange is transferred by indorsement, and the sum stated in the bill has to be paid at maturity to the holder in due course. If a bill is dishonored by the drawee or acceptor, the holder can proceed against any of the other parties to the bill, whom he chooses to hold responsible. All persons who have written their names on the bill are parties to the bill and liable thereon.

Promissory Notes. The Dutch Commercial Code lists two kinds of promissory notes: promissory notes to order and promissory notes to bearer. A promissory note to order is defined as " a document, dated and signed, by which a person promises to pay, at his domicile or at the domicile of another person within the same municipality or elsewhere, and with or without the determination of a fixed time, the sum of money expressed therein, to the order of the holder." The law which governs promissory notes to order is in principle the same as that applicable to bills of exchange. Only the provisions regarding acceptance do not find application here, because a separate acceptance of promissory notes does, of course, not take place.

Promissory notes to bearer are not subject to the law governing bills of exchange. As, however, the importance of these notes as credit instruments is insignificant, they need not detain us here.

Increase of Treasury Bills in Portfolio During War. The amount of debenture bonds in the Bank's portfolio has always been negligible. Before the war the bulk of the discounts con-

sisted of commercial bills and promissory notes. Treasury bills were also discounted, but the amount of this paper held by the Netherlands Bank was seldom very important, and there were often long periods in which the Bank held no treasury paper at all. This changed, however, at the outbreak of war, and in the years following 1914 government paper came to play a large part in the Bank's discount portfolio. Unfortunately the Netherlands Bank's weekly balance sheets until recently did not give separate figures for the discounts of treasury paper, and the annual reports as a rule only contain some occasional figures in this respect. But the available data show that during the years 1916–1917 and 1917–1918,[3] when the abundance of money which prevailed in the Netherlands during the greater part of the war period, had reduced the commercial paper in the Bank's portfolio to an unusually low level, the percentage of treasury paper in the yearly volume of discounts amounted to 70 and 78 respectively.

Post-War Increase in Commercial Discounts. After the Armistice the position changed in so far that the commercial discounts began to increase considerably. But the discounts of treasury bills also grew, and in the year 1921–1922 when both commercial discounts and discounts of treasury bills reached their maximum, the latter constituted 61 per cent. of the total volume of discounts. During the past few years, however, this percentage has substantially diminished again. In the year 1924–1925 it was not quite 39; in 1925–1926 it had fallen to 30.6. Regarding the discounts of paper of municipalities, provinces, etc., no figures are available. Before 1914 and during the first years of the war these discounts have probably been insignificant. During the latter part of the war and especially in the two years immediately following the Armistice they must have assumed fairly considerable proportions. Since then they have rapidly declined and at present they seem to be negligible.

Increasing Importance of Promissory Notes. The proportion of promissory notes to bills of exchange in the Bank's commercial portfolio has considerably changed in the course of years, with the result that the promissory notes play a much more important part at present than they did half a century ago. During the years 1921 to 1926 they averaged a little over 75 per cent. of

[3] The fiscal years of the Netherlands Bank run from April 1, to March 31.

the yearly volume of commercial discounts, as against probably about 60 per cent. during the years 1900 to 1905,[4] and not quite 37 per cent. during the years 1875 to 1880. It should be added that the discount rate charged by the Bank for promissory notes is, as a rule, one half of one per cent. higher than that for bills.

THE ADVANCES (LOMBARD LOANS). As has been stated before, the Netherlands Bank is permitted to grant advances or "Lombard loans" on stocks and bonds, merchandise, coin and bullion, paper eligible for discount, and foreign bills. In practice, however, the Bank's advance business is somewhat more restricted than might appear from this enumeration. For until very recently (November, 1925) as a rule no advances at all were made on paper eligible for discount and foreign bills, while the advances on coin and bullion are insignificant. Of the two remaining sorts of advances, those on stocks and bonds are by far the most important. In fact they constitute the bulk of the Bank's advance business. The advances on merchandise, although of greater consequence than those on coin and bullion, have never played a prominent part.

TYPES OF ADVANCES. According to the periods for which they are granted, the advances are divided into ordinary advances and advances on current account. The former used to be made, before the war, for three months; but in 1914 this term was reduced to one month. If, two days before maturity, neither party has given notice, they are tacitly renewed for the same period. The advances in current account are not granted for a fixed term, but can be paid back at any time, the minimum period for which interest has to be paid being one day. It is clear that this sort of advances is particularly suited to borrowers occasionally requiring money for short periods. In fact, practically all the larger general banks in Holland have arrangements with the Netherlands Bank under which they are entitled to take up money in current account up to a certain maximum, whenever they desire to do so. To this end they have permanent *depôts* at the Netherlands Bank, which are pledged as security for advances of this kind. If they

[4] The exact figure for these five years is not available because the Bank's annual reports of this period only give percentages of promissory notes in total discounts *including treasury bills.*

do not actually take up money under these arrangements, they pay a small charge for the custody of their *depôts*.

Rates Charged on Advances. The rate of interest charged by the Netherlands Bank for ordinary advances varies according to the kind of security, the rate for advances on foreign stocks being as a rule one half of one per cent. higher than that for advances on domestic stocks. The latter has often (but not always) been equal to the discount rate for promissory notes and consequently one half of one per cent. above the bill rate. The rate for ordinary advances on merchandise has mostly been identical with that for advances on domestic stocks, although it shows occasional movements of its own. The rate for advances in current account is the same for the different sorts of security and nearly always a full per cent. above the rate for ordinary advances on domestic stocks.

Advances to the State. The advances which the Netherlands Bank is obliged to grant to the State are made in the form of advances on current account on the security of treasury paper. They date from 1888, when it was provided in the Bank Act that they should be granted against the rate of interest for ordinary advances and that their total should not exceed Fl. 5,000,000 at a time. In 1903, however, these provisions were altered. The maximum for the advances for the State was raised to Fl. 15,000,000, and it was enacted that the Bank should not charge any interest for them. These provisions are still in force.

Relative Importance of Advances. In a study of the data concerning the Netherlands Bank's advances, it will be seen that the Bank's advance business is by no means of small importance when compared to the discount business, and that there have even been long periods (*e.g.*, the years 1905–1914 and 1915–1921), when the " other advances " considerably surpassed the discounts. The very high figures for " other advances " in 1919–1920 and 1920–1921 are due to the issue of long-term government loans in January, 1919, and May, 1920. In order to give some idea of the part played by the advances in current account among the total " other advances," it may be added that up to 1913–1914 the annual average of the advances in current account stood always below Fl. 8,000,000. In recent years the advances in current account have become considerable. During the period 1914–1926

they averaged Fl. 30,000,000, or a little over 20 per cent. of the average total of the " other advances."

DEPOSITS AND THE TRANSFER SERVICE. As fiscal agent to the Dutch Government the Netherlands Bank acts as State depository for any funds the Government may have temporarily available. At the same time the Bank accepts, as already stated before, money in current account from any of its other customers desiring to make a deposit with it. Like nearly all Central Banks, the Netherlands Bank does not allow interest on deposited money. Until 1914 it even used to charge a commission of one half of one per mille on payments (not transfers) to the account of any of its customers other than the Government. This commission, however, was abolished at the outbreak of the war.

GOVERNMENT DEPOSITS. The Government deposits need not detain us very long. Until the beginning of the nineties they were often fairly considerable and although prior to 1889–1890 the Bank did not publish separate data for the two kinds of deposits, it is known that the comparatively high level of the deposits from 1875–1895 is entirely due to deposits of government funds. But after provisions had been made in the Bank Act obliging the Bank to grant advances on current account to the State, the importance of the government deposits rapidly declined. During the last twenty years these have been so few and far between, that they may be considered almost negligible.

OTHER DEPOSITS. For a proper understanding of the Netherlands Bank's deposit account business, as far as the other deposits are concerned, it should be noted that, unlike the member banks of the United States Federal Reserve System, the general banks in the Netherlands are not bound by law to carry any reserve balances with the central credit institution of the country. Neither did they voluntarily hold appreciable parts of their reserves in the form of balances with the central bank before the war. As far as they did not keep their reserves in actual cash, the banks usually preferred to temporarily invest them in monthly loans or on call at the Stock Exchange. As a result the Netherlands Bank's other deposits have long remained at a very low level. The considerable increase they have shown since 1914 is probably partly to be explained by the abundance of short money prevailing in Holland during the greater part of this

period, and by the abolition of the commission of one half of one per mille for payments in current account above referred to.

The Development of the "Giro" System. That increase is, however, also largely due to the comparatively sudden development of the custom of making payments by means of what is usually called the *giro-* or transfer-system, which took place in the Netherlands during and after the war. Long before 1914 the Netherlands Bank had made it possible for its customers to effect their payments in this way, and the Bank had been constantly endeavoring to develop its transfer service. But until 1914 these attempts had never been very successful, because the habit of paying in cash was too firmly established in Holland. The war changed this, and, partly also as a result of an alteration in the application of the system, by which the Bank, in August, 1914, permitted persons and institutions not having an account in its books, to make use, through their own banks, of its transfer service, this branch of the Bank's activities has since developed to a considerable extent. The following figures give an idea of this development —

NUMBER AND VOLUME OF TRANSFERS EFFECTED BY THE NETHERLANDS BANK DURING THE YEARS 1913–1926 [5]

Year	Number of transfers	Amount transferred (in millions of guilders)
1913–14	70,063	340
1914–15	122,332	905
1915–16	173,199	1,684
1916–17	205,068	3,526
1917–18	231,288	4,638
1918–19	245,697	8,199
1919–20	320,005	15,173
1920–21	448,574	23,018
1921–22	533,523	24,316
1922–23	620,122	19,706
1923–24	774,125	23,453
1924–25	701,819	28,410
1925–26	642,199	31,594

For the sake of completeness it should be added that the Netherlands Bank undertakes the collection of bills, checks, coupons, etc., not payable at its offices, for anyone having an account with

[5] Source: *Annual Reports* of the Netherlands Bank.

it. A small fee is charged for such collections. At its offices in Amsterdam, Rotterdam, and the Hague, the Bank also acts as a clearing house for the principal banking institutions in those towns. Clearings are held three times a day. The balances are settled by transfers on the Netherlands Bank's books.

Methods of Credit Control. As is the case with most Central Banks, the principal method used by the Netherlands Bank to control credit, is the manipulation of the rate of discount. Speaking generally it may be said that up to the outbreak of war the predominant factor in determining the Bank's policy in this respect was the state of its metallic reserve. When the reserve percentage started appreciably to fall so as to approach its legal minimum, the Bank invariably raised the rates at which it was prepared to lend money; and it used to lower them when the reserve percentage was comparatively high and showed an upward tendency. It should be observed that it has never been customary with the Netherlands Bank, while pursuing this policy, to use artificial means in order to make its rates effective. As we have already seen, the Netherlands Bank has no authority to purchase or sell securities in the open market; and the practice followed by the Bank of England and at one time also by the German *Reichsbank,* of discounting certain domestic bills at a rate below the official discount rate, has never found favor in Holland. On the other hand, prior to 1906, the fact that only a comparatively small part of the metallic reserve consisted in gold, more or less hampered the Netherlands Bank in its rate policy by preventing it, on several occasions, from following a decline in the open market rate as closely as would have been possible otherwise. But in spite of this, the Bank as a rule very well managed to keep in touch with the money market, and it may be said that before the war its rate policy was on the whole quite effective in controlling the credit situation. The Bank rate has always been above the discount rate in the open market and mostly (especially in later years) also above what is called in Amsterdam the " prolongation "-rate, *i.e.,* the rate for monthly loans on the Stock Exchange.

Reserve Ratio no Longer Sole Guide of Discount Rate Policy. After the outbreak of war in 1914 it soon became clear that the Bank could no longer rely on its reserve ratio as practi-

cally the sole guide for its rate policy. During the first war years considerable quantities of gold were imported into the Netherlands and the reserve percentage rose to an unusual height. But in spite of this fact the discount rate for bills, which had been raised to 6 per cent. during the crisis of July and August, 1914, was never reduced below 4½ per cent. In fact the international situation of the period made it practically impossible for the Bank to reduce its rates any further. As compared with the rates of the banks of issue in the principal other European countries, the Netherlands Bank's rate was already decidedly low. A further reduction would have attracted foreign demand for credit in a measure which from the Netherlands point of view was to be considered very undesirable. On the other hand, when, in July, 1922, the Netherlands Bank did at last reduce its discount rate from 4½ to 4 per cent. the reason for this reduction was not to be found in the state of the metallic reserve (the reserve percentage being, in fact, much lower at that time than it had been during the years 1916 to 1918), but in the general credit situation of the country. It is these two factors — credit conditions in the surrounding countries and the general credit situation at home — which, as far as one can see at present, have chiefly determined the more recent alterations in the Netherlands Bank's rate policy.

The Rationing of Credit. Partly in addition to and partly in lieu of the rate policy, quite another method of credit control has been used by the Netherlands Bank during part of the period under consideration. We refer to the policy of credit rationing and moral pressure as applied by the Bank in the years immediately following the Armistice. As in many other countries a serious expansion of credit took place in the Netherlands during this period. This expansion was largely due to the fact that at that time the expenditure of the Government and of certain municipal corporations greatly exceeded their revenue, with the result that they were constantly obliged to issue large amounts of short- and long-term loans, which to a considerable extent found their way to the Netherlands Bank. It was obvious that in these circumstances, one could not expect any great success from a raise of the Bank's rates as a measure to check the expansion of credit. The municipal corporations would have been apt simply to increase taxation in order to meet the higher costs of borrowing.

And the government need not even have done this, because, as we have seen already, by far the greater part of the Bank's surplus profits reverts to the State. The Netherlands Bank therefore resorted to other measures. As early as February, 1919, it announced that it would in future reserve the right to fix the total amount of municipal paper which it was prepared to discount or accept as collateral for advances, and that it would accept such paper only after having obtained satisfactory information as to the time the paper had to run and the method of its redemption. This warning was repeated and further explained a few months later. At the same time the Bank made a special point of constantly exercising a severe control over all other applications for credit which were made to it. In doing so it adopted the standpoint that no unnecessary obstacles should be laid in the way of well considered credits for really productive purposes, but that, on the other hand, all unsound credit expansion should be checked. Finally, in a circular issued in September, 1920, the Bank called special attention to the large amounts in bonds of government loans, which served as collateral for its advances. It pointed out, that the greater part of the funds obtained by means of these government loans had been used for non-productive purposes, and that it was, consequently, highly desirable in the public interest, that the advances made by the Bank against such government bonds, should be redeemed by the borrowers as soon as possible. In order to add force to this warning the Bank raised, in October, 1920, as a supplementary measure, its rates for advances on stocks and advances on current account by one per cent. This policy of credit rationing and moral pressure has in practice shown very satisfactory results.

Effect of Foreign Bill Policy. When dealing, on a preceding page, with the methods used by the Netherlands Bank in maintaining the gold parity of the guilder, we have already briefly referred to the Bank's custom of holding some of its assets abroad, partly in the form of balances with foreign correspondents, but mostly in the form of foreign bills, which can be immediately converted, if necessary, into such balances by rediscounting. The authority to purchase and sell foreign bills was granted to the Bank in 1888, and we have seen that since the beginning of the nineties, the Bank has used its assets abroad to sell checks on

foreign countries whenever the exchanges began to rise above gold parity, and that, by doing so, it was frequently able to correct temporarily adverse exchanges without being obliged to deliver gold for export. It is clear that this foreign bill policy, as the above-mentioned practice may be conveniently called, thus acts as a method of protecting the Bank's metallic reserve; and since, before the war, a fall in the reserve percentage was the chief reason for raising the tariff of rates, the foreign bill policy was bound indirectly to have a more or less stabilizing influence on the Bank rate. The amounts of foreign bills have varied considerably in the course of years. This is partly to be explained by the fact that until 1918 the Bank Act contained the somewhat peculiar provision that the sum total of the funds, invested by the Bank in foreign bills, was not allowed to exceed for any period longer than a fortnight, the amount of what is called the Bank's available metallic balance (*i.e.*, the amount of " free " gold and silver in the Bank's vaults). But it is partly also due to the practice which has been followed by the Netherlands Bank until the very last years preceding the war, of never increasing its foreign bill portfolio — however favorable the exchanges might be for such an increase — as long as the demand for credits at home was comparatively strong. As a matter of fact, these two factors had more or less hampered the development of the Netherlands Bank's foreign bill policy before the war. The effect of the foreign bill policy in stabilizing the Bank rate cannot, of course, be expressed in exact figures. By way of illustration it may be mentioned, however, that, whereas the official discount rates of the Bank of England and the German *Reichsbank* have been altered during the years 1894 to 1913 (inclusive) 90 times and 73 times respectively, the Netherlands Bank's discount rate for bills had been changed only 36 times in the same period. As to the Netherlands Bank's balances with foreign correspondents, no figures are available; but on the whole these balances seem to have been of minor importance.

War and Post-War Changes in Foreign Bill Portfolio. During the years 1914 to 1919 the foreign portfolio was kept within very modest limits on account of the risks involved in the holding of foreign bills at that time. Since 1919 the Bank has appreciably increased it again, mainly by making (with the

authorization of the Government) considerable gold shipments to England and the United States. During the war and in the years immediately following the Armistice, although there could be no question of maintaining the parity of the Netherlands guilder in relation to the various other currencies, the Bank has often made good use of its assets abroad by supplying Dutch trade and industry at reasonable rates with the means of paying their debts to countries, the currencies of which were temporarily at a premium in the Netherlands exchange market. After the restoration of the gold standard, in April, 1925, the Bank has resumed its pre-war policy of selling drafts on foreign countries the currencies of which are legally and unconditionally on a gold basis, whenever the rates of exchange on these countries give occasion to do so.

OTHER BANKING INSTITUTIONS

Legal Control. Unlike the Netherlands Bank, the organization and powers of which are largely determined, as we have seen in the previous section, by law, the other banking institutions as such are almost entirely free from legal restriction in Holland. As a result of the Bank Act of December 22, 1863, which gives the Netherlands Bank *de facto* a monopoly of note issue, they are not allowed to issue bank notes. But for the rest they are completely free in the way they wish to carry on their business. They are not subject to any government supervision whatever, and under no legal obligation to publish periodical reports or balance sheets.

The General Banks. Among the various classes of banks other than the Central Bank, by far the most important group includes what are usually termed in Holland the general banks. Their character is not easy to describe. They do not specialize, like the joint-stock banks in England, in short-term transactions only. Neither do they operate chiefly in the investment field. Their aim, as it is usually described in their constitution, is to conduct banking business in the widest sense of the word. On principle they very much resemble the credit banks (*Kreditbanken*) in Germany. But their relations to industry, although they have considerably developed of late, are on the whole not so close as in the case of the German banks.

Credit Policies. The general banks grant both short-term credits and credits which have a somewhat longer period to run, although, for obvious reasons, they usually will take care to make sure that the majority of their loans is of the short-term type. Their credits bear partly a commercial and partly an industrial character; they very seldom grant agricultural credit. As security they accept not only bills and promissory notes, and stocks or bonds, but usually also merchandise, real estate, sureties of third persons, life insurance policies, etc. They sometimes also grant credits without any special security.

Flotation of Securities. A characteristic branch of the activities of the general banks (at least as far as regards the larger ones among them) is the business of floating securities. This often proceeds as follows: The bank extends a certain amount of credit to some industrial corporation. At the outset this credit is perhaps comparatively small and only used for the payment of current expenses like wages and the cost of raw materials, the sums borrowed being paid back at regular intervals when the manufactured articles have been sold. But the enterprise flourishes and develops, and as time goes on more credit is needed while part of it is applied to extensions of plant, improvements in methods of production, etc., and can consequently no longer be refunded within a short time. In such circumstances it is often thought desirable after a certain period to convert the credit into capital of the industrial corporation or into long-term amortization credit. The enterprise then issues new shares or bonds, and the bank acts — with or without the coöperation of other banks — as an underwriter to these securities. It takes them over from the industrial corporation in payment of the "book-credit," and makes it its business to place them among the investing public. Also in cases where industrial or other enterprises are not largely indebted to banks, they often make use of the latter's intermediation when issuing new securities, for the simple reason that the banks, by their extensive relations with the investing public, are often in a better position to sell the securities than the enterprises themselves.

Other Operations. In addition to these two main functions, the granting of credits and the floating of securities, the general banks perform a number of other operations. They receive, of

course, money on current and deposit account, and meet checks drawn against their customers' balances. They buy and sell securities for their clients (in connection with which they frequently give considerable advances to the buyers), collect drafts, checks, coupons, etc., take care of valuables, act as sureties (by way of accepting drafts for their customers or otherwise), deal in foreign exchange and foreign currencies, issue letters of credit, generally furnish insurance, and carry on various other operations of the same nature. It should be added that the deposit-account business of the general banks has for a long time been only of comparatively small importance in Holland. This is partly to be explained by the practice, which was widely prevalent in Dutch business circles, especially before the war, to invest temporarily available means in monthly loans on the Stock Exchange, instead of depositing them with banks as is usually done in other countries. But it is partly also due to the old and widespread custom of the Netherlands public to utilize even comparatively very small savings for the purchase of securities. As a result of the latter of these two factors the activities of the Dutch general banks in buying and selling stocks and bonds for customers have, on the other hand, always been rather considerable. Practically all the general banks are organized nowadays as limited stock companies.

The Structure of the System of General Banks. Owing to the large degree of freedom of the banking business from restriction and regulation by law, complete and reliable banking statistics are not available in the Netherlands. Even the total number of general banks is not accurately known. As far as I have been able to ascertain it must have amounted at the beginning of 1925 to approximately 200, as against some 125 at the end of 1911 and probably not much more than a dozen in 1881. In themselves these figures do not mean much. For a part of the considerable increase in the number of general banks is simply to be explained by the transformation of small private banking firms into stock companies, which has been one of the features of the development of Dutch banking during the past few decades. And, on the other hand, the comparative importance of the various individual banks has undergone appreciable changes in the course of years.

Concentration Movement in Banking. Apart from the Nederlandsche Handel-Maatschappij (Netherlands Trading Society), the somewhat exceptional position of which will be explained below, up to the beginning of this century practically all the general banks in the Netherlands were comparatively small institutions, mostly possessing not more than a few, if any, branches, and being, consequently, as a rule only of local importance. During the past fifteen or twenty years, however, this situation has completely changed. Similarly to what happened at a somewhat earlier date in England and in Germany, a strong tendency towards concentration made itself felt in Dutch banking, with the result that by far the largest portion of the country's banking power has become centralized in the hands of a few leading institutions which, within a comparatively short time, have developed to such an extent as to completely outgrow their brethren. Space does not permit us to describe this concentration process in detail. For a proper understanding of the subject it should be mentioned, however, that the concentration has only partly taken place in the Netherlands by way of amalgamation and the establishment of branch offices. The leading banks have also largely extended their powers by entering into friendly alliances with other banks which formally continue their existence as separate enterprises, but are in fact under control of the leading institution. At the same time they have established, in certain cases, subsidiary banks in which they incorporated as branches a number of small provincial institutions which they had taken over; but these subsidiary banks are formally also separate enterprises.

Leading General Banks.. The leading general banks are now five in number. They are the Amsterdamsche Bank (established 1871), the Incasso-Bank (established 1891), the Nederlandsche Handel-Maatschappij (established 1824), the Rotterdamsche Bankvereeniging (established 1863 under the name Rotterdamsche Bank) and the Twentsche Bank (established 1861 under the name Twentsche Bankvereeniging, B. W. Blÿdenstein & Co.). The Rotterdamsche Bankvereeniging, as its name indicates, was originally a Rotterdam concern, and although for a number of years it has an important Amsterdam office, its head office is still in Rotterdam. The Amsterdamsche Bank, the Incasso-Bank, the

Nederlandsche Handel-Maatschappij and the Twentsche Bank have their main offices in Amsterdam.

Nederlandsche Handel-Maatschappij. As has already been alluded to above, the Nederlandsche Handel-Maatschappij holds a somewhat exceptional position among the leading general banks. It was originally a trading company, largely engaged in the trade with the Dutch East Indies. In addition to its commercial activities it started, about the middle of the nineteenth century, to act as a finance company, but it was not until the beginning of the eighties that it took up banking business. During the past forty years, however, banking has come to play a part of continually growing importance among the company's activities. Its original commercial business has receded into the background, and the Nederlandsche Handel-Maatschappij is now in the first place as a general bank. But it differs from the other leading banks in that it conducts, besides its home business, a large business in the Far East and especially in the Dutch East Indies, where it acts partly as a bank in the strict sense of the word, and partly also as a finance company. In addition to its home branches it possesses now 28 overseas offices.

Importance of Leading General Banks. The predominant position of the five leading banks is well illustrated by the proportion which the total paid-up capital directly and indirectly under their control bears to the aggregate paid-up capital of all the general banks combined. The latter amounted in the beginning of 1925 to probably a little over Fl. 400,000,000. Out of this the five leading banks between them possessed fully Fl. 245,000,000. In addition the 20 institutions affiliated with one of the leading banks had an aggregate paid-up capital of approximately Fl. 70,000,000. Consequently the total paid-up capital subject to the control of the leading banks amounted to about Fl. 315,000,000 or more than 75 per cent. of the entire paid-up capital of all the general banks together.

Branches of the Leading General Banks. Apart from the overseas offices of the Nederlandsche Handel-Maatschappij, only two of the leading banks, namely the Amsterdamsche Bank and the Incasso-Bank, possess a somewhat appreciable number of branches. The other leading banks conduct their provincial business mainly through the intermediary of affiliated institutions.

Thus, for instance, the Rotterdamsche Bankvereeniging possesses in the Nationale Bankvereeniging a subsidiary with at present some 90 branch offices all over the country, while the Nederlandsche Handel-Maatschappij is closely related to the Geldersche Credietvereeniging which has at present 31 branch offices in different places.

Increase in Volume of Operations. Up to 1920 inclusive the growth of the business of the leading general banks has been practically uninterrupted; it has been especially marked since about 1911. The serious depression in industry and trade during 1921 and 1922 then brought a reaction, while during the last few years the volume of operations of the banks in question has been moving with, on the whole, only comparatively small fluctuations on a level which, although appreciably below that of the boom period 1919–1920, is still much higher than it used to be in pre-war days.

To a considerable extent this development simply reflects the movement towards concentration. But we have seen that this process has only partly taken the form of amalgamation in the strict sense of the word; it has consequently only partly affected the balance sheets of the leading banks; and there is therefore no doubt that the remarkable extension of the business of the leading banks as shown by their periodical returns, is partly also due to other causes. Among these may especially be mentioned the growing industrialization of the country; its increasing foreign trade; the abundance of money which prevailed in the Netherlands during and immediately after the war; and the declining popularity, since 1914, of the practice of investing temporarily available funds in monthly loans on the Stock Exchange. The closing of the Amsterdam Stock Exchange for fully six months at the beginning of the war, which temporarily prevented Stock Exchange loans from being called in by the lenders, made many people take a dislike to this method of investment, and led them to prefer depositing their funds with the banks.

The Private Banking Firms. Owing partly to the transformation of private banking firms into stock companies and partly also to the concentration movement, already referred to above, the number of private banks has considerably diminished in Holland during the last ten or twenty years. Nevertheless, the

private banking firms still hold a position of importance. They include some large houses of high standing, like the firms of (in alphabetical order) Hope & Co., Lippmann, Rosenthal & Co., R. Mees & Zoonen, and Pierson & Co., which transact very important financial business.

As a class the private banking firms perform the same sort of functions as the general banks. But a good many of them largely specialize in the business of buying and selling securities for their customers. This is particularly true of the smaller provincial firms, who, accordingly, sometimes call themselves "stock and bond dealers" (*commissionairs in effecten*), or also "cashiers" (*kassiers*), instead of bankers. The larger houses in Amsterdam and Rotterdam more closely resemble the general banks. They often play an important part in the issuing of and trading in stocks and bonds, while some of them are also largely engaged in financing enterprises and making loans to foreign governments. Unfortunately the private banking firms do not publish periodical reports or balance sheets, so that it is impossible to give an account of their condition and development.

THE SPECIAL BANKS

Besides the Central Bank, the general banks, and the private banking firms, there are a good many special banking institutions in the Netherlands. The principal groups of these are the colonial banks, the Amsterdam "cashier"-institutions, the agricultural credit societies, the mortgage banks, and the savings banks. We shall briefly deal with each of these groups.

The Colonial Banks. The name "colonial banks" is usually given in Holland to those institutions which, working with Dutch capital and under Dutch management, and having either their main office or one or more branches in Holland, chiefly operate in the Dutch colonies. The principal colonial banks are the Java Bank (established 1827), the Surinam Bank (established 1864), the Nederlandsch-Indische Escompto-Maatschappij (established 1857), and the Nederlandsch-Indische Handelsbank (established 1863). Moreover, the Nederlandsche Handel-Maatschappij conducts, as we have already seen, besides its home business, an

important business in the Dutch East Indies, and may therefore partly be called a colonial bank.

The Java Bank (main office at Batavia; branch office in Amsterdam) and the Surinam Bank (main office in Amsterdam; branch office at Paramaribo) are the central banking institutions of the Dutch East Indies and Dutch Guiana, respectively. As such they hold a predominant position in the colonies. But they are only of secondary importance for the Netherlands banking system, and they therefore need not further detain us here. The somewhat exceptional position of the Nederlandsche Handel-Maatschappij has already been dealt with on a previous page. We shall add here a few words about the Nederlandsch-Indische Escompto-Maatschappij and the Nederlandsch-Indische Handelsbank. What will be said of the general scope of the activities of these two institutions (both of which are legally limited stock companies) and of the rôle they play on the Dutch money market, is also true of the Nederlandsche Handel-Maatschappij as far as it acts as a colonial bank.

Credit Extensions of the Colonial Banks. Both the Nederlandsch-Indische Escompto-Maatschappij and the Nederlandsch-Indische Handelsbank chiefly operate in the Dutch East Indies. They act there as general banks in that, on principle, they conduct every sort of banking business except the issuing of notes, the monopoly of which is in the hands of the Java Bank. But as a result of the fact that they operate in a country, the economic structure of which is mainly agricultural, where industry is very little developed and capital is scarce, their activities show considerable differences as compared to those of the general banks in the mother country. In general it may be said that the colonial banks grant more agricultural credit and less industrial credit than the general banks in the Netherlands, and that the majority of their credits is of a commercial character. The exchange business of the colonial banks is of considerable importance, but their activities in floating securities and buying and selling stocks and bonds for customers are comparatively little developed in the colonies.

Relation of the Colonial Banks to the Money Market. The importance of the banks in question for the Dutch money market lies partly in the extensive exchange business they conduct, and partly in the rôle they play in the financing of the

trade with the Dutch East Indies. In addition they obtain part of their deposits in Holland, while, on the other hand, they often invest temporarily available funds on the Dutch money market. Apart from its colonial business the Nederlandsch-Indische Handelsbank also transacts a fairly considerable amount of home business nowadays. Both the Nederlandsch-Indische Escompto-Maatschappij and the Nederlandsch-Indische Handelsbank often coöperate with the leading general banks in the floating of securities in Holland. It should be added that the latter institution is not only a bank in the strict sense of the word, but also partly acts, in the Dutch East Indies, as a plantation company through its subsidiary, the Nederlandsch-Indische Landbouw-Maatschappij.

The Amsterdam "Cashiers." The Amsterdam "cashiers" or "cashier-institutions" are thus named after the old private cashiers who played an important part in the financial organization of Holland in the seventeenth and eighteenth centuries. The business of these private cashiers originally consisted in the keeping, collecting, and paying out of money for their customers. For this they charged a certain commission, but they were not allowed to lend the funds which were entrusted to them by their clients, to third persons, and, consequently, did not pay interest on deposits. Private cashiers of this kind no longer exist in Holland. The Amsterdam "cashiers" are banking institutions, legally organized as limited stock companies. They are three in number, namely the Associatie-Cassa (established 1806), with its subsidiary the Rente-Cassa (established 1864), the Ontvang-en Betaalkas (established 1813), and the Kasvereeniging (established 1865), and hold a place of their own in the Dutch banking system. On principle they closely resemble the English joint-stock banks, and differ from the general banks in the Netherlands in that they only grant short-term credits and entirely abstained from the business of floating securities. They receive deposits and (with the exception of the Associatie-Cassa) pay interest on them, discount commercial paper and grant loans on stocks, bonds, and merchandise, take care of valuables and collect and pay out money for their customers. They do not grant credits without security. The collecting business forms a very important branch of their activities; they act as collecting agents for the other banks and

for the Amsterdam stockbrokers, practically all of which have an account with one or two of the "cashiers" for that purpose. The "cashiers" daily clear their mutual debts and those to the Bank of Issue and the principal other banks, at the Netherlands Bank. They also have a *giro*- or transfer-service between them. They have no branch offices.

THE AGRICULTURAL CREDIT SOCIETIES. We have already seen that as a rule the general banks in Holland do not grant agricultural credit. The credit demands of the farmers are almost entirely met nowadays by special types of credit institutions, established on the coöperative principle by the farmers themselves, and called "boerenleenbanken," or agricultural credit societies. The creation of these societies is a comparatively recent phenomenon in Holland, the first of them being founded in 1896. But they have rapidly developed and now hold a place of importance among the credit institutions of the country. Their number amounts to over 1200 at present.

The agricultural credit societies closely resemble the German *Darlehnskassenvereine* of the Raiffeisen system. Legally they are partly coöperative societies under the Coöperative Societies Act, and partly associations under the Associations Act of 1855. Their members are mostly individual farmers, but include associations which are intended to serve agricultural interests, as, for instance, associations for the purchase of feed, fertilizer, and the like. As a rule an agricultural credit society operates only in a small area, usually one village or one parish. Accordingly the number of its members is usually not very large. Upon an average it amounts to somewhat over a hundred. The agricultural credit societies have practically no social capital of their own, but the members are liable up to the whole of their personal fortunes for the debts of their society. The societies are governed by a managing board, a board of control and a cashier, all of them to be appointed by the members.

FUNCTIONS OF THE AGRICULTURAL CREDIT SOCIETIES. The business of the agricultural credit societies is very simple. They receive deposits (time-deposits as well as sight-deposits), on which they pay interest, and they extend credits. Deposits are accepted both from members and non-members, but credits are granted to members only. The credits are given by way of loans,

secured either by mortgages or by sureties of third persons. The agricultural credit societies do not grant credits without security. The advances are made for fixed periods (usually not longer than one year) or in current account. The net profits of the societies are not divided among the members, but put aside to form the societies' surplus funds.

THE CENTRAL AGRICULTURAL LOAN BANKS. As a result of the fact that the agricultural credit societies operate in a small area and practically cater to one class of the population only, the individual societies often find themselves with an appreciable disproportion between the aggregate of their deposits and the total of their advances. A good many of them are apt to suffer from an abundance of money because the sum total of their deposits as a rule largely exceeds their aggregate advances. On the other hand there are societies where an entirely opposite situation prevails, their total deposits being almost permanently too small to allow them to meet out of their own means all the credit demands made upon them. This has led the societies, almost from the very first years of their existence, to join hands and create central institutions, where those that have money to spare can safely invest it, and which, on the other hand, are able to assist the local societies that are in need of money. Until recently these central agricultural loan banks were three in number, established at Utrecht, Eindhoven, and Alkmaar. In 1925, however, the Alkmaar bank, which was considerably smaller than the others, was liquidated, and most of its members have joined either the Eindhoven or the Utrecht institution. The central agricultural loan banks are legally coöperative societies under the Coöperative Societies Act. Their members are the local agricultural credit societies, practically all of which have joined one of the central institutions. As far as the central agricultural loan banks do not require their funds to extend loans to members, they invest them partly in deposits with other banking institutions or in loans on the Stock Exchange, partly in short-term loans to provinces, municipalities, and other public bodies, and partly also in securities or on mortgage. As a matter of course the credit demands of agriculture are particularly heavy in the spring. It sometimes happens at that time of the year that the central institutions in order to meet the credit demands of their members are obliged temporarily to

borrow money elsewhere. They are, however, in a much better position to do so than the local societies themselves would be, because they have some social capital of their own (composed of the shares that the local societies are obliged to take in the central institution on joining it), and because the local societies are jointly liable for the obligations of the central institution of which they are members. It should be added that the central agricultural loan banks exercise a certain supervision over their members, the latter being subject to examination at least once a year by examiners appointed by their central institution.

THE MORTGAGE BANKS. The mortgage banks form another important class of special credit institutions in the Netherlands. They are organized as limited stock companies and make it their sole business to lend money on first mortgage. The means out of which to extend their loans, they obtain by issuing mortgage bonds.

The Dutch mortgage banks may be divided into three groups: home mortgage banks, foreign (and colonial) mortgage banks, and ship mortgage banks. The home mortgage banks only grant loans on real estate situated in the Netherlands. The institutions of this type are now a little over 50 in number. The oldest of them dates from 1861, but the majority were founded during the period 1890–1905. The social capital of the home mortgage banks mainly serves as a guaranty fund, and is, as a rule, only partly paid up. According to the Yearbook of the Association of Managers of Home Mortgage Banks, the aggregate subscribed capital of the principal home mortgage banks amounted by the end of 1925 to Fl. 78,018,000. Out of this Fl. 12,520,000, or 16 per cent., had been paid up. In addition the banks in question possessed surplus funds to a total amount of Fl. 26,072,000. As to the amount of their bond issues, the regulations of most of the home mortgage banks provide that the sum total of their bonds outstanding may not surpass a figure equal (in the case of some banks) to ten times the amount of their subscribed capital or (in the case of other banks) to ten times their subscribed capital *plus* their surplus funds. The total of the bonds of the above mentioned banks outstanding at the end of 1925 was Fl. 725,605,000, *i.e.*, 9.3 times the amount of their aggregate subscribed capital or 7 times the amount of their aggregate capital *plus* surplus funds.

Loans of Mortgage Banks. Most of the loans of the mortgage banks are granted for fairly long periods, usually 5 to 10 years. In practice the home mortgage banks lend money chiefly on urban real estate. The demands for rural mortgage credit, the risks of which are usually considered to be less than those of urban mortgage credit, are mostly met by private persons, savings banks, life insurance companies, etc., at a lower rate of interest than the mortgage banks can afford to charge. Practically all the home mortgage banks abstain from giving industrial mortgage credits because these credits would expose them to too many risks.

Foreign Mortgage Banks. The foreign (and colonial) mortgage banks differ from the home mortgage banks in that, whilst issuing their mortgage bonds in the Netherlands, they grant loans on real estate situated abroad (or in the colonies). As a class the banks of this type are younger than the home mortgage banks, the first of them being founded in 1883. They are now 27 in number. Only two of them operate in the colonies. Most of the foreign and colonial mortgage banks date from the years after 1908. Owing to the higher risks involved in the business of the foreign mortgage banks, the capital of these institutions, as compared to the amount of their mortgage bonds outstanding, is usually appreciably higher than in the case of the home mortgage banks. At the same time their bonds bear a higher interest. The foreign mortgage banks mostly lend money on rural real estate. The majority of them operate in the United States and Canada.

Ship Mortgage Banks. The ship mortgage banks, as their name implies, lend money on mortgages upon ships. There are now a dozen of these institutions. The two oldest of them date from 1899. Upon an average the proportion between the capital of the ship mortgage banks and the aggregate of their bonds outstanding is still somewhat higher than in the case of the foreign mortgage banks. The ship mortgage banks grant loans both on sea-going vessels and on river boats. They operate partly in the Netherlands and partly abroad, especially in Germany.

Post Office Savings Bank. The first savings banks in the Netherlands were founded in 1817 and 1818. During the next sixty years their number gradually increased, until it amounted to 308 in 1880. Given the purely local character of practically all of these institutions, this figure was still decidedly low, and as,

moreover, the methods according to which the existing savings banks were managed, were for a long time rather primitive, it came generally to be felt, in the seventies of the nineteenth century, that the opportunities for saving were largely inadequate in Holland. This led to the establishment, in 1880, of the Post Office Savings Bank. The Post Office Savings Bank began operations in 1881, and its activities soon assumed considerable proportions. It was thought by many people that this would be injurious to the other savings banks; and in fact during the first years following 1881 several of the latter disappeared, while no new other savings banks were founded. At the same time, however, other tendencies made themselves felt. The existence of the Post Office Savings Bank largely stimulated the habit of saving generally, and the competition from the side of the postal institution made the other savings banks gradually improve their methods of management, so that they were able in many cases to offer more favorable terms to depositors than the Post Office Savings Bank. As a result the business of the other savings banks has continued to develop (although on the whole not in the same degree as that of the Post Office Savings Bank), while, especially in the first decades of this century, their number has also been increasing again. At present there are some 400 savings banks other than the Post Office Savings Bank. The Post Office Savings Bank has now about 1500 depositories.

Other Savings Banks. Unlike the Post Office Savings Bank, which is a government institution, the organization and management of which are entirely regulated by law, the other savings banks as such are free from legal regulation. Their organization widely varies. Out of the 400 other savings banks now in existence, some 150 have been founded by the "Society for the General Welfare" (*Maatschappij tot Nut van het Algemeen*), a philanthropic association established in 1784. They are more or less to be considered as subsidiaries of this society and partly take the form of associations, and sometimes of foundations. The remaining other savings banks are partly associations or foundations, partly coöperative societies, and partly municipal institutions or limited stock companies. Practically all of the savings banks bear a philanthropic character. They do not intend to make profits and are, as a rule, managed by their governing

boards free of charge. It should be added that during recent years a good many general banks have established savings departments of their own. These savings departments, however, form part of the business of the banks in question, and are not to be considered as savings banks in the strict sense of the word.

From 1905 to date the aggregate deposits of the Post Office Savings Bank have been in excess of those of the reporting other savings banks. Up to 1916 the excess often amounted to about 50 per cent. and more. Since then the proportion has altered a little in favor of the other savings banks. The number of pass books of the Post Office Savings Bank surpasses that of the other savings banks in a considerably larger degree, and the average deposit per pass book is appreciably lower in the case of the Post Office Savings Bank than in that of the other savings banks. It seems to follow from this that, on the whole, the depositors of the latter belong to a somewhat different class of the population than those of the Post Office Savings Bank. The deposits at the Post Office Savings Bank bear 2.64 per cent. interest. The other savings banks usually allow a somewhat higher percentage.

Other Classes of Special Banks. Besides the five groups of special banking institutions with which we have dealt in the preceding pages, a few other classes of special banks are in existence in the Netherlands. We may mention the credit associations (*credietvereenigingen*), the "banks for the middle classes" (*middenstandsbanken*), and the "advance banks" (*voorschotbanken*).

The credit associations, the first of which was founded in 1853, were originally established for the purpose of granting short-term credits to people of small means. They are organized on a mutual principle under which every customer is obliged to take a share in the association's capital, which share needs, however, only partly to be paid up. The means out of which to grant credit they find partly in their paid-up capital and their deposits, and partly by rediscounting promissory notes of their credit-taking members. In the course of years most of the credit associations have been taken over by or transformed into ordinary general banks. The "banks for the middle classes" are of a more recent date. As their name indicates they seek to supply short-term credit to small dealers and shopkeepers. They are usually organ-

ized on the coöperative principle and more or less resemble the *Genossenschaften* of the Schulze-Delitzsch type in Germany. Up to now their business has not always been uniformly successful, and several of them have been obliged to liquidate during the last few years, while others are being recognized. The " advance banks " mostly operate in close connection with life insurance companies. They usually give long-term credits on security of life insurance policies and sureties of third persons. The means to do so they obtain mostly by issuing bonds. On the whole the three classes of banking institutions just mentioned are of comparatively small importance.

RECENT DEVELOPMENTS IN DUTCH BANKING

The present survey would be incomplete without some reference to certain developments which have occurred with regard to banking in Holland as a result of the favorable position in which, from an international financial point of view, the country found itself placed after the Armistice, in consequence of its neutrality during the war. It cannot be foreseen at the time of writing what these developments will ultimately lead to, but they have recently attracted a good deal of attention in banking and financial circles both in the Netherlands and abroad; and it is therefore well worth while to review in brief outline some of their main and essential features.

Inflow of Foreign Funds to Amsterdam Money Market. It is sufficiently well known that the currencies of various countries in Central and Eastern Europe, particularly Germany, suffered from very serious depreciation during the first few years following the Armistice. This depreciation, partly coupled with the desire to avoid payment of frequently very high taxes, induced a good many persons and enterprises in those countries to transfer a larger or smaller portion of their available means to foreign countries, the monetary units of which offered better guaranties for stability in value, and among them to the Netherlands. Exact figures as regards the amount of funds which found their way to the Amsterdam money market in this manner are not available, but their aggregate must have been large. Towards

the end of 1921 it was estimated by a competent authority at about Fl. 500,000,000.

Growth of Amsterdam Acceptance Market. The abundance of money at Amsterdam which was the result of this inflow of foreign funds, began at a time when trade between Central Europe and the rest of the world was strongly reviving, and thus offered considerable opportunities to the general banks in the Netherlands, of which they naturally made use. They began to engage in the business of financing international trade on an appreciably wider scale than they used to do before the war, and particularly took in hand the acceptance business. This was considerably facilitated by the comparative stability in value which the Dutch guilder had enjoyed during the war, and also by the fact that the natural aversion which still prevailed at that time among several of the former belligerents, to directly transacting business with persons who until recently had been their enemies, made them easily prepared in many cases to make use of the intermediation of banks of a neutral country.

Since the currencies of most of the countries of Central and Eastern Europe have been stabilized, the importance of the foreign balances on the Dutch money market has appreciably diminished. But contrary to what was expected by many persons when the foreign funds began to return to their countries of origin, money has on the whole remained plentiful at Amsterdam, and the leading Dutch banks have continued to develop their activities in financing international trade.

Establishment of German Banks at Amsterdam. In the meantime, however, another important event had occurred. During the years 1919 and after, a good many of the leading German banks founded branches, agencies, or subsidiary undertakings in Amsterdam. The reasons which led the German institutions to open these Amsterdam offices are fairly obvious. London, where they had had important offices in pre-war days, was still practically closed for them. They saw that Germany's foreign trade was being financed to an increasing extent via Amsterdam, and they naturally wished to obtain a share in that financing. Last but not least, they were desirous to regain part of the deposits which they were losing in their own country as a result of the outflow of German capital to Holland.

Operations of the German Banks. During the first few years of their establishment at Amsterdam, the German banks were largely engaged in the administration and investment of the German funds that had found their way to the Netherlands. In addition they specialized much in foreign exchange business in which they acted partly for the account of numerous speculators who were endeavoring at that time to make profits out of the rapid decline of the currencies of Central Europe, and partly on behalf of German industrial undertakings, which were frequently induced to have their foreign exchange transactions effected at Amsterdam by the severe restrictions to which dealings in foreign exchange were then subject in Germany. There is no doubt that the German banks have considerably contributed in this way to develop the Amsterdam foreign exchange market. At the same time they also favorably influenced the discount market by their frequent purchases of treasury bills and commercial paper for German account.

The stabilization of the currencies of Central Europe and the return of more normal conditions in that part of the world has naturally led the activities of the German banks at Amsterdam into a somewhat different direction. Some of the smaller institutions among them, which had too exclusively specialized in the foreign exchange business, have disappeared, and the remaining ones are more and more concentrating during the last few years upon the financing of Germany's foreign trade and the granting of international credits generally.

Formation of Acceptance Companies. This state of affairs has led to still another remarkable development in Dutch banking. At the beginning of 1924 some new credit institutions had been established at Amsterdam with the special object of conducting an international acceptance business. They are the Nederlandsche Accept-Maatschappij (Netherlands Acceptance Company), the Internationale Bank te Amsterdam (International Bank at Amsterdam), and the Internationale Crediet-Compagnie (International Credit Company). They were founded by the leading general banks and some of the more important private banking firms in Holland in coöperation with some German, English, Swiss, and Swedish banks and banking firms, and are more or less to be considered as subsidiary undertakings of these insti-

tutions, their capital being entirely in the hands of the latter and not of the general public. Their foundation was mainly a result of the desire of the leading Dutch banks to avoid unnecessary competition in the granting of foreign credits and to lead this part of their activities into proper channels by concentrating it in the hands of special institutions suitable for the purpose. It should be added that the Nederlandsche Accept-Maatschappij and the Internationale Crediet-Compagnie entirely specialize in the acceptance business. The Internationale Bank te Amsterdam also performs other international banking operations.

Exact figures as regards the business of the acceptance companies are not available. But they seem to be developing in a satisfactory way and already hold a place of importance in the Dutch banking world.

Measures of the Bank of Issue in Connection with the Acceptance Business. It will be observed from the foregoing that the Amsterdam money market is showing a distinct tendency during recent years to become of increasing importance as an international financial center. The significance of this development is appreciably enhanced by the fact that from its very beginning it has had the full support of the Bank of Issue, which has been among the first to recognize its weight and is taking a keen and active interest in it. Especially in the last few years the Netherlands Bank has repeatedly shown that it seriously desires, as far as its position as the country's central credit institution and principles of sound policy allow it to do so, to coöperate with the other banks in trying to stimulate the Dutch acceptance business. The foundation of the acceptance companies has had the outspoken sympathy of the Netherlands Bank, and the Bank has at once declared itself ready, if so required, to rediscount their bills, provided that it approves of the character of the transactions concerned, and, of course, that the bills comply with the Bank's rules as regards discountability of bills in general. Originally one of these rules was that bills in which foreign interests were involved were eligible for discount only if the discounting bank could prove that the bills also served a Dutch interest. In March, 1925, however, this rule was altered, and the Netherlands Bank now only requires in cases like this that the bank in question in general keeps Dutch interests in view, and that the credits granted are

not in conflict with Dutch interests. Very recently the Netherlands Bank has taken still another step. In alteration of the policy which it had hitherto followed in this respect, it decided in March, 1926, to admit, on principle, to its discount, bills accepted or indorsed by banking institutions of foreign origin which have been established in the Netherlands after 1914. Under present circumstances this facility applies particularly and practically only to the German banking institutions in Holland. It is subject to certain restrictions among which is the condition that the banks in question must be organized as a firm or body corporate under Dutch law. Nearly all the German institutions in Amsterdam, however, are organized in this way, and it is hoped that the admission of their bills for rediscount with the Netherlands Bank will promote the extension of the Amsterdam discount market and favorably influence the acceptance business in Holland generally.

Dutch Bank Statistics. For statistical information regarding the banking and monetary system of the Netherlands the reader is referred to the Annual Reports of the various banks and further in particular to the following publications:

Jaarcijfers, published by the *Centraal Bureau voor de Statistiek* (*Central Bureau of Statistics*), The Hague;

Financieel Jaarboek, published by the *Dagelijksche Beurscourant*, Amsterdam;

Eisfeld, C. *Das Niederländische Bankwesen* (The Hague: Martinus Nijhoff, 1916), Vol. II; and

Marck, Th. H. A. M. van der *Boerenleenbanken* (Wassenaar: Delwel, 1924).

CHAPTER X

THE BANKING SYSTEM OF ITALY

With a Preliminary Note on the Monetary and Credit System

BY

Francesco Lo Faro

THE MONETARY SITUATION BEFORE THE WAR

The Kingdom of Italy was formed in 1859, and from that date until 1865 it had a gold and silver metallic currency amounting to approximately one thousand million lire and a fiduciary currency amounting to 265 million lire. The latter, equivalent to barely one fourth of the specie then in circulation, consisted of (1) 132 million lire in notes issued by the Banca Nazionale of the Kingdom of Italy, and by the Banca Nazionale Toscana, the only two banks authorized to issue notes convertible into gold; (2) 133 million lire represented by credit certificates issued by the Bank of Naples and the Bank of Sicily, not then authorized to issue bank notes.

In the early part of 1868 the unsatisfactory condition of public finance and a grave commercial crisis radically modified the ratio between the metallic and the paper currency. In those early days of national life Italy had to provide herself with the equipment of a big modern State and to remedy the defects of the policies hitherto pursued by the many small states into which the Peninsular was divided prior to 1861. The economic poverty of the country forced it to have recourse to foreign loans which were made both to the Government and to private concerns. Economic development had to be stimulated by the preliminary outlay of public money; such expenditure was largely uncovered, and the burden was heavily increased by the cost of the service of the loans.

Budget Deficit 1860–65. During the years from 1860 to 1865 the budget deficit rose to over 2,500 million lire. To meet this liability loans were obtained for some 1,700 million lire, besides millions secured by the issue of bonds for railway construction; 44 million lire worth of Crown lands were sold, and the remainder were pledged as collateral for a loan of 150 million lire. Nor were there any prospects of an improvement in the near future as the estimates for 1866 showed a deficit of 26 million lire, and the probability of a war with Austria loomed up with its consequences of further heavy expenditure, increased deficits, and more costly loans. National credit was shaken. Italian government stock, quoted in 1860 at 80 on the Paris Bourse, fluctuated around 65 and 67 in 1862, fell to 64.40 in 1865, and to 43.90 at the end of April, 1866. The panic which had seized foreign investors spread from government to other Italian securities which were thrown on our market for hundreds of millions of lire in the space of a few months. As the quotations for these securities were considerably higher on the Italian than on foreign exchanges, they were purchased on a large scale by Italian speculators and paid for by sending abroad gold obtained from the banks by pledging government securities. Thus their fall on foreign markets promoted speculation and raised foreign exchange rates, and as the exchange rose it became ever more profitable to export the precious metals.

Inconvertible Papers. The crisis was accentuated by the conviction that a régime of inconvertible paper currency would have to be introduced. The mere suggestion of this induced foreign bankers to discount their drafts on Italy so as to receive immediate payment in gold; it led depositors to withdraw from the banks so as to convert their money into coin and avoid future paper payments and holders of bank notes to present them for payment while this was still possible. The available funds held by the banks were thus depleted, and they were compelled to refuse discounts. Trade and industry, deprived of banking credit, were unable to meet their liabilities. Business came to a standstill; the soundest concerns were threatened with bankruptcy; appeals for help were addressed to the Government from all sides. On May 1, 1866, when war on Austria was declared, the Government issued a decree releasing the Banca

Nazionale from the obligation of exchanging its notes for gold in return for a loan of 250 million lire, and authorized the other banks to issue, each in its own region, inconvertible paper money.

By 1870 these issues amounted to 570 million lire, exclusive of the 278 million lent by the Banca Nazionale to the State. The then Minister of Finance, Quintino Sella, anxious to avoid the growth of the national debt, the service of which would have increased the budget deficit, had recourse to further note issues. In 1870 the Banca Nazionale's loan to the State was raised to 500 million lire, in 1871 there was a further increase of 50 million; in 1872 another loan of 300 million was obtained, to be drawn on during the period 1872–76 as required.

Growth of Bank Issues. This increase in the fiduciary currency issued on behalf of the State was paralleled by an increase in that issued by the banks on their own account. In 1869 the Banca di Sicilia and in 1871 the Banca Romana obtained the note issue privilege in addition to the four banks already enjoying it.

State and bank circulation rose to the following amounts from 1870 to 1874:

	1870	1871	1872	1873	1874
Millions of lire....	1,073	1,310	1,478	1,562	1,597

In 1874 a law introduced by Finance Minister Minghetti replaced the issues made by the Banca Nazionale on behalf of the State by an issue made collectively by a consortium of the six banks. These loaned 940 million lire to the Treasury secured by government stock bearing interest at the rate of 40 to 50 centimes per hundred lire. By this means the State paid its debt to the Banca Nazionale. At the same time, the note issues of the banks were regulated by a law which forbade their being in excess of three times their capital wealth or paid-up capital stock, or three times the cash held by them in specie or notes of the consortium. The bank notes were made exchangeable on demand against notes of the consortium and recognized as legal tender in all provinces where a branch of the issuing bank existed.

For Italian finance 1874 was an historic year, as the budget was then balanced and the determination taken to preserve the balance at all costs. Note issues on behalf of the State were limited to 940 million lire.

Redemption Discussed. During the following years the repeal of the régime of inconvertible paper and the return to a metallic currency were taken into consideration. But it was only in 1881 that a concrete plan was adopted. The Government secured a foreign loan of 654 million lire, wherewith it repaid 44 million lire to the Banca Nazionale due for a gold loan obtained in 1877 which had to be repaid three months prior to the repeal of the inconvertible paper régime; it retired notes for 600 million lire issued by the consortium; against the outstanding debt of 340 million lire it issued Treasury notes payable in specie on demand.

Thus the specie circulation, then standing at 550 million lire, was raised to 1,700 million, and the notes of the consortium and of the banks fell from 1,665 million to 1,000 million lire. On the withdrawal of its notes the consortium dissolved; the notes issued by the banks continued to be legal tender until December 31, 1883, though payable in specie on call.

The resumption of specie payments removed the barriers isolating the Italian from wealthier foreign markets; foreign capital came in the form of bank deposits, loans for settlement, and discounts attracted to Italy by the higher rate of interest paid, and no longer deterred by the fear of exchange fluctuations. This influx of new capital, estimated by some at over 500 million lire, led to a sharp rise in the price of government and public securities and to a decline in interest and discount rates.

Business Expansion. This led to considerable business expansion in which the banks of issue participated. They made land credit loans, financed speculation in real estate, assisted importers of foreign goods desirous of benefitting by the forthcoming increase of customs duties, intervened to assist speculators on the stock exchange by loans for settlement, advances, and discounts, and to finance these transactions they issued notes in large quantities. While the note issues increased the specie cover was reduced, as shown by the following figures:

	1883	1885	1887	1889
		(millions of lire)		
Circulation	794	947	1,075	1,116
Reserve %	51	40	37	34

After 1885 the demagogic policy pursued by the parliamentary Left then in power, led to a new series of budget deficits, amounting for the period 1886–91 to 464.4 million lire. They were met by foreign loans, the interest on which weighed heavily on the budget.

Meantime the inflation in all branches of business activity due to heavy note issues led to grave economic crises which arose after 1887 in agriculture, and more especially in the South, on the repeal of the commercial treaty with France, in the manufacturing districts as a result of the too rapid withdrawal of foreign capital with which they had been built up, and in trade as a consequence of the protectionist policy inaugurated by the new customs' tariff of 1887. These crises led to a further large increase in note circulation due to the endeavor of the banks to come to the assistance of customers unable to meet their liabilities.

The Banks and the Crisis. The banks, which had unduly favored speculation of all kinds and stock-exchange arbitrage, found themselves involved in the general crisis. They held credits for large amounts which they could not collect without long delays, and their resources and activities were tied up in investments unsuited to banks of issue. The new note issues made during the crisis were in excess of business requirements, the metallic cover was steadily declining, and all this led to a general slump of confidence, symptoms of which were the growing aggio on gold and the alarming demand for specie in exchange for notes.

The crisis came to a climax in 1893 with the liquidation of the Banca Romana and the failure of the Credito Mobiliare which involved in its ruin the Banca Generale. Depositors hastened to withdraw their savings, government securities slumped, the premium on gold rose to 16%, gold and silver coin was exported in increasing amounts, migrating to other countries belonging to the Latin Union.

Inconvertibility of the paper currency, repealed *de jure*, was reintroduced *de facto*. Notes of 1 and 2 lire were issued to meet the lack of token money; Treasury notes rose from 334 to 600 million lire and the right to change them for specie was temporarily suspended; the banks of issue, reduced to three after the collapse of the Banca Romana and the amalgamation of the two Tuscan banks with the Banca Nazionale as the Banca d'Italia, were no

longer required to pay their notes in gold but limited themselves to exchanging them for Treasury notes. Nearly 400 million lire worth of specie had left Italy. On the other hand, the issues of the three banks amounted on 31st December, 1894, to 1,126 million lire, which in addition to the 600 million lire worth of treasury notes, brought the paper circulation up to 1,726 million lire. A paper money regime had returned and all traces of the repeal of inconvertible currency had disappeared.

Improvement of Economic Conditions. The economic conditions of Italy gradually improved after the crisis of 1893. Under the direction of Finance Minister Sonnino the budget was balanced, and from 1898 to 1907 surpluses were secured amounting to 469 million lire.

The new situation is shown by the following data:

	1897	1905
	(millions of lire)	
Treasury notes	576	442
Foreign Trade	2,122	3,721
Banks of Issue reserve fund	447	1,220

Metallic specie returned in large quantities, the banks rebuilt their reserves, thus making it possible to increase the note circulation to meet increased business requirements while raising the percentage of the cover:

	1899	1905
	(millions of lire)	
Bank circulation	1,180	1,406
% of metallic cover	43%	70%

This conjuncture of favorable circumstances enabled Finance Minister Luzzatti in 1906 to effect the conversion of the funds, reducing the interest from 4% to 3.75% as a first step, and to 3.50% in five years' time. The transaction was fairly easy, as out of a total of 8,100 million lire demands for repayment at par did not exceed 4.5 million. National finance was greatly benefitted and a considerable surplus on the budget was secured from year to year until 1908–09.

Renewed Deficits. From then onward a series of deficits ensued, the situation being complicated by such events as the great earthquake which destroyed Messina and Reggio di Cala-

bria in 1908 and by the Lybian war in 1911. At the close of the financial year 1912–13 the deficit amounted to 307 million lire. These deficits were met by further issues of notes on behalf of the State.

CURRENCY INFLATION DURING AND AFTER THE WAR

The outbreak of the European war was the signal for a severe monetary crisis. The limitation of international trade led to a sudden halt in business activities which had not yet found an outlet in the increased activity of the war industries. Initiative was paralyzed by uncertainty, leading to liquidations, the withdrawal of deposits, and the hoarding of money, with consequent insufficiency of the circulating medium. The crisis was met by further note issues which enabled the banks of issue to assist trade and industry.

Prewar Situation and War Changes. On the eve of entering the war Italy's total currency circulation amounted to 3,593 million lire, of which 2,201 million was issued on behalf of commerce and 1,392 on behalf of the State.

During the first year of the war, issues on State account continued, bringing the total up to 5,050 million while the ratio of the reserve fell to 35.94%.

Meantime, business was placing itself on a war footing and the depression of the first months made way for a period of prosperity.

In 1916 the circulation increased with the growth of the activities of the war industries. The limit of the note issues for advances to various concerns was raised from 600 to 1,000 million lire.

In 1917 the issue of Treasury notes and of bank notes on State account increased to an extraordinary extent. The total circulation suddenly rose to 10,173.8 million lire. To meet the needs of war finance recourse was increasingly had to irredeemable paper currency.

In 1918 the total circulation was further increased by 3,500 million lire, inclusive of large note issues made on account of commerce. But this was not solely due to business developments, more especially in connection with the munition industries, but to

the fact that the banks subscribed on a large scale to the war loans and Treasury bill issues, investing in these securities a large part of the note issues nominally made on account of commerce but which really served to finance the war.

The war closed with a great military victory for Italy but with the following disastrous monetary situation:

Total bank note circulation....	Lire 11,790.3	million	
Treasury note circulation......	1,931.8	"	
Total note circulation.........	13,682.1	"	
Metallic or equivalent reserve...	1,931.8	"	i.e., a ratio of 15.84%

Effect of the War. The war left Italy economically exhausted and impoverished. The state of public finance, both central and local, was serious, her currency vitiated, her agriculture deteriorated by neglect and by the reduction of live stock, her merchant marine decimated, her railways greatly injured, her stocks of merchandise depleted. She was moreover unduly dependent on foreign countries as a result of Government indebtedness and of her urgent need for large supplies of raw materials and foodstuffs. Under such conditions the cessation of hostilities could not and did not bring prosperity. Munition industries came to an immediate standstill, leading to widespread business depression. Factories and workshops had to reorganize on a peace footing. The lack of raw materials hindered many branches of production, which suffered also from lack of transport facilities, the coal famine, and the high cost of all necessities.

Economic hardships were aggravated by political and social disorders, and by a demagogic financial policy, the result of the organic weakness of parliamentary government in Italy. Labor troubles, strikes, class warfare involved heavy losses, discouraged enterprise, and hindered recovery. Financial policy was at the mercy of the claims advanced by government employees and socialists, who succeeded in compelling the State to sell bread below cost, and to subsidize the unemployed. Heavy increases in taxation; the total confiscation of excess war profits and the emergency tax on capital failed to supply the means for meeting increased liabilities, and the Government resorted to the issue of Treasury bills and government stock, and continued to inflate the currency.

Monetary Position to 1920. The monetary situation in 1919 and 1920, the two most turbulent of the postwar years, was as follows:

Year	Circulation on ac/ of Commerce	Circulation on ac/ of the State	Reserves
	(millions of lire)		
1919	5,615.6	12,700.1	2,044.9
1920	8,988.7	13,005.9	2,077.8

The increase in 1920 in the circulation on account of commerce, is accounted for by the issue in that year of a great national loan to facilitate subscriptions to which the banks increased their note issues, nominally on account of commerce. Mention must also be made of the low bank rate ruling ever since the declaration of war which now led to real credit inflation.

Reductions in public expenditure, increased revenue from taxation, and the sale of Treasury bills on a large scale on the home market made it possible to reduce the note circulation which fell to 21.4 milliard lire in December, 1921. As long as the budget remained unbalanced and the economic and social life of the nation was a prey to disorder it was, however, impossible to pursue a firm deflationist policy.

THE RECONSTRUCTION POLICY

The Government placed in power by the revolution of October, 1922, took over a budget which had closed in June of that year with a deficit of 15,760 million lire. In 1922–23 this deficit had been reduced to 3,029 million lire and the note circulation had been curtailed by 1,800 million lire. In June, 1924, the deficit did not exceed 418 million lire; in June, 1925, a surplus of 417 million was secured. These results were achieved without recourse to emergency measures.

The fiscal system was improved by strengthening the organs of assessment and collection and by reducing tax evasion; State industrial services were reorganized, among them the State railways which in 1927 yielded a surplus of 500 million lire as against a deficit of 1,460 million in 1922. As a result, the revenue from normal taxation had increased by 5,598 million lire on June 30, 1926. At the same time expenditures had been strictly controlled and

when the financial year 1925–1926 closed it stood at 18,775 million lire as against 35,461 on June 30, 1922.

The monetary and financial policy of the Fascist Government aims at eliminating those factors which disturb exchange values. This has guided its action in settling the foreign war debts, in balancing and safeguarding the budget, in reducing the internal debt, in supervising exchange rates, in unifying the note issue, in taking measures to bring capital investments into keeping with the possibilities of industrial expansion, in safeguarding savings deposited with the banks.

Amortization Plans. The service of the Washington and London debt settlements has been provided for by organizing an Autonomous Amortization Fund which collects reparation payments due under the Dawes plan and uses them to meet Italy's liabilities under those agreements. The outstanding foreign debt has thus been reduced to the Morgan loan, amounting to 510 million gold lire. The proceeds of that loan were used to refund 2,500 million lire loaned by the Banca d'Italia to the Treasury. This amount was placed to the Bank's reserve which thus rose from 1,947 million gold lire on October 31, 1926, to 2,438 million. The ratio of the gold note cover thus rose from 10.62% to 13.40%.

Disposal of the Floating Debt. After appropriating 500 million lire a year on the budget for repaying the residual debt of the Treasury to the Bank of Italy, and providing for the service of the Morgan loan, it became necessary to take immediate steps for consolidating the floating debt which stood at 27,700 million lire in June, 1926. As the Treasury bills fell due they were presented for payment in considerable amounts (2,494 million lire were thus paid out by the Treasury in a period of 4 months) to meet the requirements arising from the prevailing stringency on the money market. The success of the Government's monetary policy was endangered unless a settlement could be made.

At the same time, the Government was desirous of taking into due account the legitimate needs of agriculture, industry, and trade, adversely affected by the compulsory conversion of the short dated Treasury bills. With these needs in view it decided to issue the Lictor's loan, which mobilized funds lying fallow and enabled the Bank of Italy to make advances and afford credit

to productive activities with money actually existing in the country, and without recourse to any form of inflation.

The prestige of the Régime insured the success of the Lictor's Loan, which made it possible, in the words of the late Luigi Luzzatti, to avoid the dilemma of inflating the currency or unduly curtailing credit facilities.

The crowning result of the revalorization policy was secured in December, 1927, when the lira, quoted at 30.536 to the dollar in August, 1926, was stabilized at the rate of 19 to the dollar.

CREDIT INSTRUMENTS

The following instruments of credit are in current use in Italy: Bank notes; promissory notes; bills of exchange; checks and bank drafts; circular notes; credit certificates; warehouse warrants; script of the national debt which may be registered, to bearer, or mixed, *i.e.*, registered but with half yearly coupons attached payable to bearer; land credit certificates and agricultural credit bonds; Savings bank books registered in the name of the depositor, registered but payable to bearer, to bearer without stating the name of the depositor, to bearer but stating the name of the depositor; current accounts against which check books are issued; Treasury bills; interest-bearing certificates, being provisional securities containing a promise of the bank to pay a given sum received on long-term deposit at a higher than normal interest rate, payment to be made on presentation of the certificate at maturity; delivery orders for goods in transit and bills of lading, both of which can be used as security for bank credits and loans. Other negotiable securities are stock certificates for shares in joint stock companies which may be registered or to bearer, and bonds issued by commercial companies.

Checks Little Used. It may be mentioned that the system of using checks drawn against bank accounts for making payments, so generalized in the United States and Great Britain as to amount to an important subsidiary currency, is still in a rudimentary stage in Italy. The Ministry of Finance is now studying the amendments to existing laws required to popularize the check as a means of payment, and meantime the Treasury has begun

to make its own payments by this means instead of by cash payments as heretofore.

BANKS OF ISSUE

History and Organization. The unification of the note issue privilege in the Banca d'Italia only dates back to May, 1926. It was preceded by 65 years' experience of plurality in banks of issue. We must therefore describe the system just relinquished; its history coincides with that of the Italian banking system.

From 1860 to 1870 only the Banca Nazionale Sarda and the Banca Nazionale Toscana were authorized to issue notes. The Bank of Naples and the Bank of Sicily issued credit certificates and warrants. When the States of the Church were annexed to the Kingdom of Italy the Banca Romana was added to the list of Banks of Issue and in 1872 the Banks of Naples and of Sicily and the Credit Bank of Tuscany began to issue real bank notes to bearer. The need of reorganizing bank note circulation was felt, and on April 30, 1874, six banks were authorized to issue notes: the Banca Nazionale del Regno, the Banca Nazionale Toscana, the Banca Toscana di Credito, the Banca Romana, and the Banks of Naples and Sicily. These formed a consortium.

In 1892 the Banca Romana was liquidated, and the Banca Nazionale del Regno, the Banca Nazionale Toscana, and the Banca Toscana di Credito amalgamated to form the Banca d'Italia.

Reorganization of Note Issue. The reorganization of the note issue began with the Act of August 10, 1893, which restricted the issue privilege to the Banca d'Italia, the Bank of Naples and the Bank of Sicily and fixed a ratio between the note circulation and the capital resources of the banks. This provision was, however, repealed in 1898 on the ground that the growth of circulation should depend on the growth of business and not on that of the bank's capital, part of which might consist of unliquid securities of nominal value only.

In 1910 the legislation on banks of issue and note circulation was codified, the maximum normal limit for the note circulation being fixed at 908 million lire distributed as follows:

Banca d'Italia	L. 660,000,000
Banca di Napoli	L. 200,000,000
Banca di Sicilia	L. 48,000,000

Notes issued in excess of these amounts had to be covered in full by gold coin or bullion, with the exception of notes representing advances made to the Treasury.

A series of Royal decrees issued in 1914 to meet the situation arising from the war doubled the normal note circulation.

ADVANCES TO THE TREASURY. Advances to the Treasury, bearing interest at the rate of 1.50%, were not included in either the ordinary or the special circulation limit.

The total amount which the Banks of Issue could advance to the Treasury was originally fixed at 115 million lire for the Banca d'Italia, 30 million for the Bank of Naples, and 10 million for the Bank of Sicily. When the European war was declared the amount was first raised to 485 million lire, but subsequently a series of Decree Laws authorized the banks to make further advances, guaranteed by Treasury bills registered in their name bearing interest at the rate of 0.20% to defray the cost of printing the notes.

These were known as " special " advances, to distinguish them from the " statutory " or " ordinary " advances, which remained fixed at 485 million lire.

STATUTORY RESERVE POSITION. We give below the status of the reserves for 1911, the first year following the adoption of the new regulations, and for 1925, the last year of the plural system of banks of issue.

Description (thousands of lire)	1911	1925
Gold	1,268,068	1,133,810
Silver	125,780	124,626
Foreign Treasury Bills	116,483	39,731
Certificates of credits held abroad		5,619
Foreign Bank notes	58,731	1,127
Other equivalent values		180.111
Total	1,569,062	2,040,774

The reserve covering debts on call, originally fixed at 40%, was reduced in 1919 to 20%, consisting entirely of Italian legal tender in metallic specie, foreign specie accepted as legal tender in the Kingdom, and bullion. The circulation represented by advances to the Treasury was fully covered by the respective credit vouchers which, together with the irreducible reserve, formed a guarantee in the exclusive interest of the bearers of the respective notes.

Such circulation also had a metallic cover of not less than one third of its value.

The following is a comparison of the leading assets and liabilities of the bank, as shown in their statements for December 31, 1913, and on December 31, 1925, the last year preceding the centralization of the issue privilege.

	ASSETS					LIABILITIES
Year	Discounts	Advances	Securities	Internat. credits	Note circulation	Debts on call
			(millions of lire)			
1913	693.4	163.6	328.9	130.0	3,376.8	230.0
1925	6,520.3	3,915.3	519.1	3,407.7	19,349.7	2,285.5

Industrial Securities. In 1915 a Consortium for Subventions on Industrial Securities was established to assist the Banks of Issue in making advances and discounts to meet business needs during the war period. In March, 1922, a special Autonomous Section of this Consortium was opened to facilitate the liquidation of credits held by the banks, more especially the " frozen " credits of the Banca Italiana di Sconto, to meet the losses caused by its failure, and to tide the Banco di Roma over the grave situation in which it found itself, due to over-investment in unliquid assets. This Section was administered by the Banks of Issue, but as a distinct and separate organ. No liability was assumed by them for losses resulting from the said immobilizations; but specific receipts, adequate to meet such losses as might be incurred were assigned to the Section. The assistance afforded by the Banks was limited to opening credits on which the Section could draw for the funds it required in its work of liquidation. On April 30, 1926, the total outstanding credits held by the Banca d'Italia against the Autonomous Section amounted to 3,381 million lire, covered by accumulated reserves to the extent of 1,413 million lire. As soon as the losses above referred to were settled all further activities of the Autonomous Section were stopped, and the Government decided to use the securities on which its reserves were invested to reduce by a like amount the debt to the Bank of Italy by cancelling notes for that amount.

A decree law of November 6, 1926, closed down the Autonomous Section, and the task of realizing any outstanding cred-

its until then intrusted to several bodies, was centered in a Liquidating Institute which is to wind up the business with all due expedition with a view to a further reduction of the note circulation. Considerable results have already been achieved, and the outstanding debt to the Bank of Italy stood on April 30, 1928, at 259 million lire.

UNIFICATION OF THE NOTE ISSUE. The centralization of the note issue in one bank had frequently been proposed, but considerations of a political and regional character had hindered carrying this measure into effect. The Fascist régime has definitely eliminated antiquated regional prejudices, and therefore, in the interest of the currency régime, and in view of conditions prevailing on the money markets at home and abroad, the National Government decided to unify the issue service. A Decree Law of May 6, 1926, limited to the Banca d'Italia the privilege of issuing notes or equivalent securities payable to bearer on demand, and provided that the gold and equivalent valuta held by the Banks of Naples and Sicily should be assigned to that bank. Until 1930, and without time limit in the case of credit certificates, the Banks of Naples and Sicily will continue to issue securities inscribed in the name of the holder, and existing agreements entered into between them and the Banca d'Italia regulating the reciprocal acceptance of such securities will remain in force until that date.

Subject to the supervision of the Ministry of Finance they may also obtain from the Banca d'Italia discounts and advances at special rates, not to exceed 1% below the official bank or interest rate. Thus the two Southern Banks will not lack adequate resources to meet special needs which may arise.

By centralizing the note issue two main objects have been attained: (1) fuller control of currency expansion so as to make it correspond to the evident economic needs of the community, the more effective regulation of the money market, and the possibility of supervising effectively other banks; (2) the two Southern Banks have been enabled to mobilize their reserves, utilizing them for productive purposes in the interest of development in the South of Italy.

THE BANCA D'ITALIA. The Act of May, 1926, unifying the note issue, that of December, 1927, stabilizing the lira at its new

gold parity, and the Royal Decree of June, 1928, regulating the relations between the Treasury and the Banca d'Italia have radically modified its status.

The *Banca d'Italia* is a joint stock bank, established in 1893 with a capital of 300 million lire, reduced on two occasions by one tenth to 240 million lire, and raised in June, 1928, to 500 million lire. Deliberative powers are vested in the general meeting of shareholders, and the administration is entrusted to a superior Council which, subject to the sanction of the Government, appoints the Governor of the Bank.

The Decree Law of December 21, 1927, places the Italian currency on a gold exchange basis, and requires the Bank of Issue to exchange its notes on demand, at its head offices in Rome, for gold bars of a minimum weight of 5 kg, at the rate of 100 lire= 7,919,113 grammes of gold, or, at the Bank's choice, for notes of countries whose currency is on a gold basis. The notes are converted at the exchange rate fixed by the Bank which may never exceed the gold export point.

The Bank is required to maintain the exchange rates quoted for the Italian lira within the gold points by purchasing or selling gold and by operating on the exchange market. The gold points are fixed for export at 19.10 lire to the dollar and for import at 18.90.

The National Exchange Institute, founded in 1926 to act for the Treasury on the exchange market at the time of the acute currency depreciation, has now become a section of the Bank, which holds its capital, and thus has the means of regulating the foreign exchange market in Italy.

Instead of a fixed limit, the note circulation of the Bank is now regulated by the requirement that its notes and all other sight liabilities be covered by a reserve in gold or equivalent credits at a ratio of not less than 40%. Should the reserve fall below 40%, a tax levied at a rate one-tenth higher than the bank rate is charged on the uncovered portion if it does not exceed the whole circulation by more than 10%. This tax is further increased by one-tenth of the bank-rate for each further 10% difference in the ratio between the circulation and the prescribed cover. The Bank is free to discover the ratio between its reserves in gold and equivalent credits.

On May 31, 1928, the reserves of the Banca d'Italia consisted of

Gold and bullion	L. 4,884.6	million
Gold credits on foreign countries	5,796.1	"
Foreign Treasury bills on gold basis	1,493.1	"
	12,173.8	million lire

affording a cover of 59.22% of all the Bank's sight liabilities.

The Bank is required to make temporary advances to the Treasury for amounts not to exceed 450 million lire at an interest rate of 2% per annum. The notes representing these advances are secured by a 40% cover. All the provisions under which the Treasury could obtain "special" advances from the Bank have been repealed, and the outstanding debt to the Bank for such advances has been wiped out with the plus values resulting from the revaluation of its gold and equivalent reserves at the new parity.

Under the new laws the Banca d'Italia regulates the credit market through its functions as the bankers' bank of rediscount; it regulates the trend of the money market by its discount rate; it is vested with powers of inspection and supervision over all joint stock banks and is consulted by the Minister of Finance on all requests for permission to open new or amalgamate existing banks, to secure foreign loans, or to increase the capital of joint stock companies.

Bank of Issue Transactions. The business which the Bank of Issue may transact is limited to that specified in its statutes, as follows:

(a) *Discounts* of commercial paper, maturing in a period not to exceed four months, indorsed by two or more persons or firms of recognized solvency; discounts of Treasury bills, warrants issued by general or bonded warehouses, and coupons of securities on which it is authorized to make advances. The Minister of the Treasury fixes the bank rate, which he can change as market conditions demand. Exceptional rates of not less than 3% are made in the case of 3-month bills presented and indorsed by first-class firms and banks; and the bills presented by Peoples Banks (Banche popolari), mining credit banks, and certain agricultural discount and credit banks for financing works of public utility can be discounted at 1% below the normal bank rate.

(b) *Advances,* for periods not exceeding 4 months, on govern-

ment stock, Treasury bills, securities guaranteed by Government, securities payable in gold and guaranteed by foreign Governments, precious metals, silk, and warehouse warrants.

(c) *Sale and purchase,* on spot or term, of 3-month bills and checks payable in gold on foreign countries.

(d) *Direct investments* may be made by the Bank of Issue in Italian government stock or other securities issued by or guaranteed by the State. Besides these, certain other investments are allowed by law.

(e) *Deposits* on current account may be received, interest on which may not exceed two-thirds of that paid on the Post-Office savings deposits. Should such deposits exceed a certain fixed amount the Bank is required to reduce its circulation by one-third of said excess. It may not open lines of credit on current account nor grant overdrafts.

Since 1893 Banks of Issue have been debarred from doing a land credit business, as the long immobilization of credit required is unsuited to them. Measures were taken at that date to wind up the outstanding land credits held by the Banks of Naples and Sicily and by the former Banca Nazionale del Regno merged in the Bank of Italy.

Should the Bank of Issue transact business unauthorized by its statutes, it is subject to a tax levied at a rate triple that of the bank rate on the whole business thus illegally transacted and for the whole duration of the transaction.

Should the profits declared by the Bank of Issue exceed 5%, the Treasury is entitled to one-third of such excess if the net profit does not exceed 6%, and to one half should it exceed that amount.

THE BANK RATE. The Bank of Issue cannot alter its rate of discount in accordance with variations in the available supply and the current demand for money, as is the practice with the ordinary credit banks. It must safeguard its metallic reserve, and must therefore keep steadily in view the foreign exchange rates which govern fluctuations in the demand for specie to meet the requirements of international trade.

As a rule the bank rate should be lower than the interest rate charged on advances, as bills are almost always paid on maturity and so afford the Bank the means wherewith to meet the demands of depositors and debts on call; whereas the period for which ad-

vances are made can be tacitly extended on maturity. Indeed, the leading foreign banks discount bills at a rate lower than that charged for advances. But in Italy the sums advanced on securities are comparatively much smaller than those loaned on discounts, and if a higher rate were charged on advances it might adversely affect the value of government and government-guaranteed securities by reducing the demand for them, which would work to their depreciation and injure our credit at home and abroad.

THE TREASURY SERVICE IN THE PROVINCES. Ever since 1894 this service had been discharged by the Bank of Italy. In that year the rules regulating the Banks of Issue were revised, the need of Government economies was keenly felt, and it was desired to compensate the Bank of Italy for the risk it had taken in liquidating the Banca Romana. Moreover, an example in this field had been set by foreign Governments who for many years past had recognized the advisability of intrusting this service to a bank rather than to Government agencies. The Central Treasury Service, which regulates the whole cash movement of the State and is the fulcrum of the financial and Treasury transactions, is however, discharged by the Treasury itself.

SUPERVISION OF BANKS OF ISSUE

The Bank of Issue is placed by law under close government supervision, exercised by the Ministry of Finance, the cost of which is met by the Bank itself. It is carried out by a special Inspectorate, assisted by an Advisory Commission presided over by the Minister of Finance, and consisting of three Senators, three Deputies, and five other members appointed by the Government. This Commission is consulted on the printing, distribution, custody, and cancellation, and on the movement of bank notes in general; on proposals for amending the statutes of the Bank; and on all measures for carrying out the provisions of the law regulating it.

The activities of the Ministry in the field of inspection are various. A Government Inspector is present at the general meeting of shareholders, at the sittings of the Superior Council of the

Banca d'Italia, with the right to suspend execution of any decision he deems contrary to the provisions of the law, regulations, of statutes of the Bank. The Minister can always exercise this right within five days of the meeting. He examines the balance-sheets and assures himself that they correspond to the book entries. The bank sends a statement to the Ministry every ten days showing the business transacted.

The Ministry orders inspections at frequent intervals to make sure that the rules regulating the note issue are strictly observed. Twice a year it makes an unannounced and simultaneous verification of the cash balance in all the seats, branches, and agencies of the Bank, as well as special verifications at the main branch offices of cash and securities belonging to the depositors or to the bank itself, so as to ascertain that all is in order and in conformity with the provisions of the law. Every three years the Minister of Finance orders a special and fuller inspection of all the services discharged by the Bank on behalf of the public and of the Treasury. On the basis of these inspections he draws up his annual Report to Parliament.

The Bank of Naples. The Bank of Naples, organized as an autonomous corporation, has a capital of 50 million lire. It has branch banks, offices and agencies but their activities have never extended beyond the territories originally assigned to it in the South of Italy. It has an agency in New York organized for safeguarding, collecting and transmitting the savings of Italian emigrants.

It is administered by a Director General appointed by the Minister of the Treasury after consulting the Council of Ministers, and by a Board of Directors under the supervision of the General Council. This latter consists of *ex officio* and elected members belonging to the provincial, municipal and commercial representative organs of the city of Naples. The Board, presided over by the Director General, consists of three delegates and two deputy delegates selected by the General Council from among its members and two directors appointed by the Government. The Bank of Naples acts as a Savings bank, an agricultural credit bank, a pledge bank, and discharges the service connected with emigrant remittances from abroad.

The Bank of Sicily. This Bank has a capital of 12 million

lire and is organized and administered on the same lines as the Bank of Naples. It acts as an agricultural credit bank, and a savings bank for the Sicilian provinces.

The Bank of Naples and the Bank of Sicily are public corporations, *i.e.*, public administrations, foundations in the real sense of the word. Their statutes describe them as autonomous public credit institutes. They are trusts placed under Boards of delegates designated by the Government and by the provinces and municipalities concerned. All their transactions are of an administrative, savings, provident, or charitable description. Their profits are assigned to purposes of public utility or go to increase their capital resources. Their officers are public officials.

LAND CREDIT BANKS

The cycle of land credit legislation closed in Italy when it was codified in the law of July 16, 1905. The characteristic features of land credit require that such business be transacted by banks organized on special technical and juridical lines. In 1890 all land credit business had been concentrated in a single bank, the Istituto Italiano di Credito Fondiario, to which a monopoly of such business was to be granted throughout Italy on condition that it accumulated a capital of 50 million lire within three years. But this projected monopoly fell through, and in 1905 the régime of concessions was inaugurated.

Companies and banks desirous of doing a land credit business must obtain a permit from the Ministry of National Economy into which the three former Ministries of Agriculture, Commerce, and Labor, have been amalgamated. The permit is granted by Royal Decree issued after consultation with the Council of State.

And credit banks are of two kinds (1) those with a paid-up capital of not less than 50 million lire, empowered to do business throughout the country. The Monte dei Paschi of Siena, the Instituto delle Opere Pie di San Paolo of Turin, the Savings Banks of Milan and Bologna, the Instituto Italiano di Credito Fondiario, and the Credito Fondiario Sardo belong to this class. They can be authorized to extend their business to foreign countries where large bodies of Italian immigrants reside.

(2) Banks with a limited sphere of action, *i.e.* (a) those with a paid-up capital of not less than 2 million lire working in districts where no local land credit banks exist; (b) credit associations of landowners owning real estate valued at not less than 5 million lire.

Land Credit Business. The following business is transacted by land-credit banks: (a) first mortgage loans, repayable by amortization, made on real estate up to one half of its estimated value; (b) the acquisition, by cession or surrogation, of mortgage or privileged credits which they render repayable by amortization; (c) the issue of land bonds, for a face value equivalent to the capital amount loaned, on the proceeds of which the aforementioned business is transacted; (d) advances made by opening a line of credit on current account secured by a mortgage on the same conditions on which the loans are made. When loans are secured for the exclusive purpose of discharging residual liabilities for the purchase of farm property or for releasing it from perpetual lease charges, the bank may lend up to three-fifths of the value of the property mortgaged.

Loans are made either by opening a line of credit on current account in favor of the borrower, or by the issue of land bonds which the bank undertakes to place. Land-credit banks thus act only as intermediaries, collecting money from capitalists who seek a safe investment at a low rate of interest, and lending it to owners of real estate who by giving a mortgage on their property as collateral secure the advantage of paying a low rate of interest and of returning the loan by annuity payments extended over a long period of years.

The loans are made on condition that there be no previous mortgage on the property or that the previous mortgages, when added to that given as collateral for the loan, do not exceed half or three-fifths of the value of the property; that the property be such as to yield a sure and continuous income over the whole period of the loan amounting to more than the annuities due to the creditor.

The Land-Credit Contract. In all land-credit contracts it is implicit that default on even one of the installments closes the transaction, entitling the bank to claim forthwith payment in full. When the bank has to distrain to recover payment of annuities

due it can have recourse to the same summary procedure by which the Government distrains for the recovery of taxes. This right is valid even when the property distrained on belongs to provinces, municipalities, or other corporate bodies. Besides foreclosing the mortgage or distraining on the property, the bank can ask the Court for an order granting possession. If this be granted it receives the income and profits accruing from the estate, which net of management expenses and tax charges are applied to the payment of amortization annuities as they fall due.

The Court may assign the property to the bank, but, under arts. 663 and 665 of the civil and penal code, the latter is not bound to accept it or the conditions consequent on such acceptance. In such cases, after the property has been put up at auction three times, the bank may seek authority of the Court to dispose of it by private agreement. Should the bank, however, desire that the property be adjudged to it, it must sell the same within a period of ten years. This provision, consequent on that which forbids land-credit banks from purchasing real estate, other than that required for housing their offices or guaranteeing preëxisting credits, is explained by the desire of the legislators to prevent them from speculating in real estate and running the risk of possible depreciation in value.

If the property foreclosed or distrained on is purchased by an outsider he must, within twenty days of the completion of the purchase, pay over to the bank that part of the purchase price which corresponds to the outstanding credit held by it for capital, accessory charges, and costs.

Land Loan Certificates. Most loans are made by handing the borrower, or placing on his behalf a certain number of land loan certificates. These are detached from books with counterfoils, numbered progressively for each series. All the certificates bearing a given rate of interest form a series. Each certificate has a face value of 500 lire. The bank may, however, issue five divisional vouchers of 100 lire each against each 500-lire certificate deposited with it. The certificates can also be grouped in multiples of five or ten.

Certificates are issued to bearer, registered in the name of the holder, or registered in the name of the holder but payable to

bearer, and have the legal status proper to each of these instruments. The interest rates on land certificates vary from 3.50% to 5%. Within these limits the banks can issue them at the rate they deem best suited to the market conditions. The interest coupons are half-yearly, but the banks may issue certificates with quarterly coupons attached.

Fundamental Credit Principles. A fundamental rule of land-credit business is that at each half-yearly date of maturity the sums recovered by the bank must correspond to those it returns to the certificate holders. Thus at the end of each half year the bank sums up the amounts received from borrowers on account of amortization quotas and cash repayments made prior to maturity; it subtracts therefrom the amount of any losses incurred, and the result shows the number of certificates to be retired at the beginning of the ensuing half year. The certificates thus retired are drawn by lot on February 1 and August 1 of each year in the presence of the public and of an official delegated by the Government. The numbers drawn are published in a special supplement to the Official Gazette sent to all land-credit banks. The certificates are retired for cash at par, and no interest is due for the half year in which they are drawn.

Land-credit certificates may be converted on a plan approved by the Ministry of National Economy, and the banks may at any time retire those outstanding at par and issue in their stead others at a lower rate of interest. This form of investment is favored by granting the privilege of insequestrability to land-credit certificates and to mortgage credits on open account.

Government Supervision. The Ministry of National Economy supervises land-credit banks. It sees that they transact no business other than that authorized by law; that the due ratio between cash mortgage loans and paid-up capital is observed; that the certificates issued correspond to loans made; that they are drawn by lot in due form, etc. The banks must transmit to the said Ministry the decisions of their Boards — which can be vetoed by ministerial decree, — a bi-monthly business statement, an annual balance-sheet, etc. The Minister can order an inspection to be made at any time.

The most important of the land-credit banks is the Istituto

Italiano di Credito Fondiario, a joint stock company with a capital of 100 million lire. Its charter was granted for a period of 50 years, renewable on the expiration of that term. Its activities are restricted to land-credit business, but in 1919 it was authorized to open a separate credit and savings department. It may only issue land-credit certificates. Two thirds of the Board of Directors, the Chairman of the Board, one third of the auditors, and the Director of the bank must be Italian nationals. The bank may make loans on mortgage security in legal tender or in certificates payable in legal tender, or in gold, or in gold certificates. In the latter case the borrower undertakes to pay the average exchange rate on the amortization quotas and interest payments so as to maintain the ratio between the real value of the loan granted and the certificates received.

The Istituto Italiano di Credito Fondiario is placed under stricter supervision than the other land-credit banks. A permanent Government Commissary is deputed to the central headquarters and, besides the general right to report any supposed irregularities to the judiciary, the representatives of not less than 5 per cent of the holders of outstanding certificates may themselves send in a report to the Ministry of National Economy.

AGRICULTURAL CREDIT

Agricultural credit has been organized in Italy on two lines, one prevailing in North Italy results mainly from the spontaneous efforts of the parties concerned, who have formed coöperative credit associations — Peoples' Banks, Rural loan banks, etc. — to meet their requirements in this field. We will describe these banks under a different heading. Here we will first deal with the facilities afforded for agricultural credit as a result of Government action.

The more important laws providing agricultural credit facilities under this system were those enacted in 1901 empowering the Savings Bank branch of the Bank of Naples to transact agricultural credit business in the Southern Provinces and in Sardinia, and that of 1906 which established an agricultural credit branch in the Bank of Sicily. In April 1922 a law was enacted codifying

the several agricultural credit measures. It recognizes three kinds of agricultural credit loans:

(1) Agricultural credit for working expenses may take the form of (a) loans for periods not exceeding 5 years for the purchase of stock, machinery, etc., and other purposes until such time as the crops are harvested and their products fully utilized and transformed; (b) advances made on warehouse certificates issued for farm products; (c) loans to agricultural associations for the purchase of farm requisites for the use of their members, or for advances to members on farm products which the association proposes to market collectively.

Such loans are secured by a lien on the crops and their products, or on the stock, machinery, and implements for the purchase of which the loan was made. If the borrower fails to make payment in full on maturity, the magistrate, at the suit of the bank, can order the seizure and sale of the property on which the lien is held. Loans of this description are made by promissory notes. The Ministry of National Economy fixes each year the maximum rate of interest which agricultural credit banks may charge on loans for working expenses. The interest rate charged by intermediary agents may not, without special ministerial permission, exceed by more than 2% the rate they themselves pay to the banks from whom they obtain the funds loaned.

(2) Agricultural credit loans for farm improvement can be obtained for preparing the soil, sowing the crops, and for improvement, within certain limitations, of lands and buildings. Such loans enjoy the privileges granted to those made for working expenses, and both forms of credit are regulated on similar lines.

(3) Agricultural land-credit loans may be made for purchasing the farm, for agrarian improvements, for making small holdings, to secure release from encumbrances and perpetual rent charges on the farm, for the conversion of land debts, for the erection or improvement of the farmhouse, stables, granges, and outhouses; for building roads on the farm; for securing a supply of drinking or irrigation water; for improving, draining, or consolidating the lands; for rewooding; and for any other work for the permanent improvement of the farm. Such loans are secured by a mortgage on the land.

Loans to Tenants. Agricultural land-credit loans can be made

not only to owners but also to tenant farmers when the owner is willing to give valid mortgage security. Loans to tenants cannot, of course, be of longer duration than the lease. Mortgage security is required, except for purposes which by their nature and short duration may properly be described as farm improvements. These loans may be made in the usual way, or by the issue of agricultural credit certificates handed to the borrower for him to negotiate, or else placed for him by the bank itself. Loans of the latter description are only allowed when secured by a first mortgage. The Government can authorize agricultural credit banks to issue such certificates for amounts not to exceed ten times the value of their paid-up capital or of the capital assigned to them.

Agricultural Credit Banks. A series of laws enacted between 1897 and 1914 organized special regional agricultural credit banks to supply farmers with working capital and credit for farm improvements. Regional agricultural credit banks were established for Liguria, the Venetian Provinces, and Central Italy. In the South of Italy the Savings branch of the Bank of Naples does an extensive agricultural credit business transacted through the agency of local banks. The Cassa Provinciale was established to meet the special needs of Basilicata, with headquarters at Potenza. In Calabria the Istituto Vittorio Emanuele III per il Credito Agrario attends to the needs of the farmers. In Sicily the agricultural credit department of the Bank of Sicily was authorized to provide all forms of agricultural credit and to make land purchase loans to enable local government bodies and coöperative associations to purchase crown lands for division into small holdings. The Government contributes to the interest payments on mortgage loans made by this department in a measure not exceeding 2.5%. The department can issue agricultural land-credit certificates. In Sardinia the Casse Provinciali di Credito do an agricultural credit business in the provinces of Cagliari and Sassari.

All these banks act as central banks for the commercial and coöperative credit banks, the Savings Banks, and the sundry agricultural corporations duly authorized by law to do agricultural credit business, to all of whom they afford credit by discounting their bills.

The local banks act as agents between the regional credit banks

and the farmers, thus fulfilling a very valuable function by facilitating credit business through their personal knowledge of the farmer and his needs, and the supervision they can exercise over the use to which the loans are put.

But although considerable assistance had thus been given to agriculture, the results were deemed inadequate in view of the fact that the total loans thus secured amounted in 1926 to no more than 515.7 million lire. In July 1927 a Decree Law revised and unified the whole system. Under it loans to farmers for working capital are made by the agricultural credit banks above referred to against agricultural paper (cambiali agrarie) having the same legal status as commercial bills, secured by a first lien on growing crops, live-stock, and farm equipment. The land-credit banks, the National Social Insurance Fund and the National Bank of Labor and Coöperation are also empowered under the new law to transact this class of business, the credit mobilized for this purpose amounting approximately to 2,000 million lire.

For the purposes of land improvement credit, a National Consortium has been formed with the financial assistance of the Treasury, the Banks of Naples and Sicily, the Credit Institute for Savings Banks, the National Social Insurance Fund, the National Fund for Accident Insurance, the National Bank of Labor and Coöperation, the regional agricultural credit banks, the land-credit and joint-stock banks, and the Provident and Savings banks, specially authorized to that effect by the Minister of National Economy. An initial capital of 276 million lire was subscribed to this Consortium, which is empowered to issue bonds up to ten times that amount, extinguishable by annuities in 30 years.

Supervision. Agricultural credit banks are placed under the supervision of the Ministry of National Economy on the same lines as those in force in the case of land-credit banks. Banks engaged in other lines of business, but also authorized to transact agricultural credit, must notify the Ministry of National Economy each year of the business of this kind which they purpose doing and on what terms. They must keep separate books for agricultural credit transactions and transmit to the Ministry periodical statements and annual reports.

The Italian Government has steadily followed a policy of

stimulating and assisting agricultural progress, and therefore grants agricultural credit banks tax exemptions and legal facilities which vary from place to place and from bank to bank.

SAVINGS BANKS

These are banks opened to receive savings on deposit and invest them in productive enterprises. They issue savings deposit books, which represent the credit held. Their work is of eminent social importance as it develops in the masses the sense of thrift through saving. The legal and juridical characteristics of these banks have given rise to much discussion, some authorities holding that they are in the nature of public utility institutes, others that they are commercial companies. They are non-profit making concerns, placed under government supervision as being of public interest, and any surplus reserve is assigned to public or charitable purposes. They are not organized as commercial companies but have a juridical status of their own, regulated by a special law, and in case of bankruptcy they are not subject to ordinary procedure but to a special form of liquidation under the supervision of the Ministry of National Economy. Their non-commercial character is evidenced by the fact that the law forbids the payment of interest on contributions made by members and founders as well as all participation of the directors in any profits. Only banks regulated by the provisions of the law of 1888 can call themselves Savings Banks.

They may be founded by associations of persons or by corporate bodies on the basis of a foundation deed, statutes, and a certificate showing that a first endowment fund of not less than 3,000 lire has been deposited with the Cassa Depositi e Prestiti or with the Bank of Issue.

The Ministry of National Economy examines the statutes setting forth the regulations for deposits, withdrawals, schedules, deposit books, mode of investing capital and deposits, use to which the net annual profits are to be assigned, etc. If the statutes are found in conformity with the provisions of the law the Minister, after consulting the Council of State, issues the decree establishing the Savings Bank which is then incorporated. The

decree, together with the foundation deed and the statutes of the Bank, are published in the Official Bulletin of Provident Institutions. Thereupon the original endowment fund is released from the bank in which it had been deposited.

If the Savings Bank is founded by an incorporated body it is generally administered by a Board of Directors appointed thereby. Banks founded by an association of persons are administered, like all limited companies, by the general meeting of members, the Board of Directors, and the Board of Auditors. All administrative mandates conferred by the assembly or by the founders are honorary. The directors are subject to special penalties which ensure strict administration. Should irregularities occur in the administration the Board of Directors can be dissolved by Royal Decree on the advice of the Council of State. In such cases a Royal Commissioner is appointed who reorganizes the administration in accordance with the statutes within a period of three months.

Government Supervision. Government supervision is exercised over these Savings Banks in the same fashion as over other public utility banks. The Minister of National Economy can veto the decisions taken by the Board of Directors as in the case of land-credit banks; he can, as already stated, dissolve the Board; he can wind up the bank by Royal Decree should it have lost not less than half its capital and should the founders, or the general meeting convened *ad hoc,* refuse to reëndow it with sufficient capital to ensure the regular resumption of its work.

The typical business of Savings Banks is to receive deposits against which pass books are issued. The law requires them to place their funds in safe liquid investments. Within this limitation the founders can freely determine by their statutes the investments the Bank is authorized to make. The statutes must state specifically not only the nature of the investments but also the ratio of mortgage loans and lines of credit opened on mortgage security to total assets, for such investments, though safe, are of long duration and the statutes require that not more than one-fourth of the deposits and capital of a Savings Bank be thus tied up. Sometimes they are authorized to do certain lines of business not ordinarily contemplated in their statutes, such as land and

agricultural credit, the service of the National Social Insurance, and the Accident Insurance funds, loans for building and purchasing workmen's dwellings, loans to municipalities and provinces, loans for the redemption of costly debts, for carrying out public works, for the purchase of buildings required to house public services, for taking over such public services direct, etc. They are hardly ever allowed to invest in industrial securities as such investments are considered too risky. Some Savings Banks are excluded by their statutes from discounting bills. They may not purchase real estate except that required for housing their own staffs.

Amalgamation. In 1927 there were no fewer than 1200 Savings Banks in Italy, but in December of that year a Decree Law required those holding deposits for less than 5 million lire to amalgamate with the leading Savings Bank in their respective provinces. The extension of this provision to those holding less than 10 million lire was left to the discretion of the Minister of National Economy. Furthermore, all Savings Banks were grouped into regional federations which coördinate their activities and build up, in addition to the reserves held by each bank, a common fund available for the needs of any of the federated banks. The purpose of this legislation is to create six or eight organizations on the lines of the Lombard Provinces' Savings Bank which collects the savings of eleven Lombard provinces and boasts 1,200,000 depositors and deposits and reserve funds amounting to some 3,800 million lire. In 1926, 137 Savings Banks held deposits amounting to over 12,132 million lire.

Tax Liability. Savings Banks are granted the same tax privileges allowed to agricultural credit banks and for the same reasons. Italian Savings Banks constitute a real financial power and their varied activities have considerable influence on the economic life of the nation.

In 1911 the Association of Italian Savings Banks was formed, each bank retaining, however, its full autonomy. The Association provides a central information organ for promoting closer relations and the exchange of reciprocal services between members, and acts as an advisory office on legal, administrative, financial, and fiscal matters of general interest.

This Association promoted the establishment of the Credit

Institute for Italian Savings Banks incorporated in 1921, to which the Banks may assign part of their assets. Nine-tenths of the sums thus allocated are set aside to form a special reserve. The Institute facilitates the transaction of banking business as between its member banks, and is building up a new and powerful agency for the discharge of duties of high economic import and social value which the several banks, taken separately, would be unable to perform.

In 1924, on the initiative of the Lombard Provinces' Savings Bank, the first International Thrift Congress was held in Milan, at which the important decision was taken to found an International Savings Institute. To this organization 4,650 Savings Banks in 27 countries now belong. Its functions are those of a propaganda bureau and a liaison and intelligence center for Savings Banks throughout the world.

POSTAL SAVINGS BANKS AND THE CASSA DEPOSITI E PRESTITI

The Post-Office Savings Banks were opened in 1875 on the English model to encourage saving, among the poorer classes, including those living remote from banking centers, by enabling them to deposit any surplus funds with the post office, at a low rate of interest, but with the right to withdraw on demand. They were established at a time when the ordinary Savings Banks had not yet developed, especially in rural districts. The Post-Office Savings Bank service was coupled with that of the Cassa Depositi e Prestiti, thus realizing an improvement over the British system by achieving a twofold purpose, that of securing an influx of money to the Cassa and that of fully detaching the administration of the Post-Office Banks from that of the Treasury by entrusting it to a self-governing body under parliamentary management and control such as the Cassa Depositi e Prestiti.

The Post-Office Savings Banks act as collecting agencies, the Cassa Depositi e Prestiti as the agency for holding and investing the savings. For this reason we will consider them jointly.

THE COLLECTION OF SAVINGS. (a) The Post-Office Savings Banks collect savings through the post offices which issue books inscribed in the name of the depositor when he makes his first deposit, accept subsequent deposits, entering them on the book, pay out sums withdrawn on account or in settlement of the credit held, keep a current account for each book issued, accept orders for the purchase of government stock or for the conversion of book credits into deposits with the Cassa Depositi e Prestiti, collect half yearly interest payments on certificates of the public debt registered in the name of the holder, and transact such business on behalf of charitable institutions and other legally registered bodies, municipalities, and provinces.

The Post-Office Department pays over the available funds thus collected to the Cassa Depositi e Prestiti, and when in need applies to it for the funds required for the service of the deposits. A regular receipt is given for all business transacted between the two administrations. At fixed dates the Post Office transmits to the Cassa a summarized statement of accounts. Seven-tenths of the annual profits earned by the Post-Office Savings Banks are paid over to the Treasury, while three-tenths are placed to the reserve and invested in Italian consolidated stock or in other securities issued or guaranteed by the State, or in ordinary and special municipal and provincial bonds. The Post-Office Savings Banks are supervised by the same Commission which supervises the administration of the Cassa Depositi e Prestiti, consisting of three Senators, three Deputies, and a Director of the State Board of Audit.

POST-OFFICE ACCOUNTS. Post-Office savings books are generally issued in the name of the depositor, more rarely to bearer. They can be issued to adults and minors, to corporations, societies, and institutes, even if they are not persons at law. Deposits can be made in cash, matured coupons of the consolidated debt, or by post-office order.

The person in whose name the deposit stands, or his authorized representative, can withdraw the deposit on presenting the book. The post office, however, is not bound to pay on call but may do so within a period varying, according to the amount to be withdrawn, from 10 to 60 days from the date of notice. Withdrawals can be made at a post office other than that which issued the

book. Deposits not exceeding 20,000 lire, or if sent from abroad those not exceeding 50,000 lire, bear interest. On sums in excess of these amounts no interest is paid. The rate of interest is fixed by a decree issued by the Minister of Finance. The books are sent once a year to the Ministry which enters the amount due to each for interest. Post-Office Savings Bank books cannot be seized or pledged for debt; they can, however, be seized by order of the criminal courts.

(a) The Cassa Depositi e Prestiti is a public utility bank, collecting savings in the form of voluntary deposits or deposits made as collateral, and investing them in loans to provinces, municipalities, and incorporated public utilities.

The Cassa administers the funds ear-marked for civil and military pensions and those of various important provident insurance institutes organized in behalf of the staff of local and central government administrations not entitled to pensions. Its General Direction forms a section of the Ministry of Finance; supervision is entrusted to a special office under the State Board of Audit. The Cassa derives its resources from the Post-Office Savings Bank and from deposits which it receives in cash, government stock, municipal and provincial bonds, Treasury bills, shares and bonds of joint stock companies and partnerships, municipal and provincial credit certificates. Deposits are either voluntary or compulsory, the latter being classified as those made on demand of courts of law or public administrations, or given as security, or in discharge of encumbrances. On all cash deposits the Cassa pays interest at a rate fixed by the Minister of Finance. In 1926 it stood at a net rate of 2.80% on deposits in discharge of encumbrances, at 2.50% on voluntary deposits, at 2% for those made at the demand of the courts or public administrations. Voluntary deposits can be withdrawn on call at any time; compulsory deposits can be withdrawn on the order of the Court or public administration, or when the reason for the deposit is shown to have ceased.

Loans to Provinces. The savings collected by the Cassa Depositi e Prestiti are used mainly in making loans to provinces, municipalities, and associations, and to a minor extent they are invested in government stock and in advances to the Treasury. It should be noted that the law requires that not less than half

the Post-Office savings deposits be invested in government stock or securities guaranteed by the Government, so as to ensure a large reserve of liquid assets wherewith to meet any contingency which may arise. Loans can be made to the aforementioned bodies for duly authorized public works, for the redemption of debt, and the purchase of buildings for housing public services. The rate of interest on the loans is fixed each year by the Minister of Finance. In 1926 it stood at 5.75%. Certain privileged loans are made at the rate of 4%. Loans may not be made for more than 50 years, and they must be amortizable either by a fixed annuity inclusive of interest and capital, or by a decreasing annuity covering a fixed sum for capital and a decreasing sum for interest.

A special autonomous branch of the Cassa extends loans to municipalities and provinces against the issue of bonds for the redemption of debts incurred for certain kinds of public works. This method is only used in making large loans exceeding the normal resources of the Cassa, and requiring the coöperation of other banks.

The large resources placed at its disposal by the Post-Office Savings Banks have enabled the Cassa to finance almost all the activities of local government bodies, and to come to their aid in times of public need.

Deposits of the Cassa. In 1863 the Cassa Depositi e Prestiti held cash deposits for 48 million lire, and security deposits for 43 million. On January 1, 1926 the respective figures stood at 3,674 million and 9,886 million lire. In 1876, one year after the opening of the Post-Office Savings Banks, they held in deposit two and a half million lire; in 1905 the deposits amounted to 1,000 million lire; in 1926 they stood at 10,994 million. One half of these savings are invested in government or government guaranteed securities, the other half in loans to municipalities, provinces, consortiums, and certain incorporated bodies. On January 1, 1926 outstanding loans amounted to 4,505 million lire; holdings of government stock to approximately 5,000 million. These figures show the importance and notable development attained by the Post-Office Savings Banks and the Cassa Depositi e Prestiti in a period a little exceeding 50 years.

PLEDGE BANKS

Under a recent decree of June, 1923, these banks, which combine charitable with credit activities, are divided into two classes, those holding large interest-bearing deposits and acting mainly as credit banks, and those which do not. Those pertaining to the first class come under the provisions of the law of July, 1888, regulating Savings Banks; the others are subject to the regulations for public charities.

Pledge banks make loans secured by personal property of all descriptions which they store until the loan matures, returning it to the owner when he has discharged his liability in full. By making the loan the bank acquires the right to refund itself out of the pledged property should the borrower fail to meet his liability for capital and accessory charges on maturity, or alternatively it can take action against the defaultant.

There are 54 pledge banks receiving deposits, of which 27 belong to the first and 27 to the second category. In 1925 they held over 800 million lire in savings deposits.

PEOPLES' COÖPERATIVE BANKS

Coöperative credit, the most notable expression of the coöperative movement in Italy, was organized in Italy as a result of the efforts of the late Luigi Luzzatti by the establishment, in 1868, of the first Peoples' Bank, on lines similar to those of the Schultze Delitizch banks in Germany, but with limited instead of unlimited liability. These banks have been defined as " companies with variable capital, so regulated as to favor an exchange of services between the company and its members and vice-versa." This definition shows that the purpose of the Peoples' Banks is to provide credit for their shareholders through coöperation and saving.

Membership is accessible to all, as the nominal value of the shares is limited, as a rule, to 50 or 100 lire, and no member may hold shares for a nominal value exceeding 5,000 lire. Further, to facilitate membership almost all these Peoples' Credit Banks

accept weekly payments, as low as one lira, on account of the share or shares subscribed. The confidence of depositors has, however, transformed some of these Peoples' Banks — notably those of Milan and Novara — into great credit institutions.

Deposit Banks vs. Peoples' Banks. We will briefly state the differences which distinguish them from joint stock banks. (a) Peoples' Banks can be organized either as limited or unlimited liability companies; in most cases the liability is limited; (b) participation in the capital stock is limited and so is the right to vote; (c) the bank must be established by public deed; (d) the directors incur the same duties and responsibilities incumbent on those of joint stock banks but they are not required, as are the latter, to give security; (e) the capital of the Peoples' Banks is unlimited and variable and so is the number of shareholders, each of whom is entitled to cast one vote only, regardless of the number of shares he holds; (f) the bulk of the bank's customers consists of its shareholders, who not only enjoy liberal terms but receive back at the end of the year in the shape of dividends part of the sums paid as commission and interest on loans; (g) Peoples' Banks can open before three-tenths of their subscribed capital has been paid up; (h) they are required to place 20% of their profits to the reserve until it amounts to at least one-fourth of their capital. They enjoy special tax exemptions.

Work of Peoples' Banks. These coöperative Peoples' Banks do a very important deposit business. In all of them the fiduciary deposits greatly exceed the capital and reserve, and enable them to carry on ever more varied and useful activities. Tied by no restrictive laws regulating the use of their resources, these banks have collected large amounts, adapting the form of the deposit to the requirements of the localities and the wishes of the population (current accounts with check books, small savings accounts, notes at fixed maturity, etc.). At the same time the nature of the deposits, made by the poorer classes, makes it essential to invest them in liquid assets which can be readily realized to satisfy at all times the calls made by depositors.

All the resources of the Peoples' Banks, consisting of paid-up shares, deposits, and the proceeds from the issue of bank drafts, are invested as follows: (a) loans and discounts, by far the most important branch of their business. The very large number

of such transactions shows the preference always given to small or moderate over large loans, to individual applications rather than to those of associations, and to coöperative rather than to commercial concerns. (b) Advances and settlement transactions on gilt-edged government and industrial securities, mortgage loans, and agricultural loans. These two latter form an important item in the business transacted by the Peoples' Banks of Milan, Novara, Cremona, Lodi, Modena, Bologna, Ferrara, Ravenna, and others. (c) Government securities and Treasury bills, more especially the latter as they insure the full refund of capital and the possibility of selling or securing advances from the Bank of Issue on the investment at any time on the most advantageous terms and without delay. (d) Some of these banks, notably those of Milan, Modena, and Ferrara, act as Treasurers for municipalities, corporations, consortiums, municipalized services, etc.

In 1924 there were 827 Peoples' Banks with 495,000 members, a share capital of L. 4,576,146, property valued at L. 218,665,000, deposits standing at L. 4,168,247,000, and discounts at L. 2,742,-841,000.

Rural coöperative banks (Casse rurali), introduced in 1883 mainly through the efforts of Senator Leone Wollemborg, provide personal credit for the small peasant farmer through loans made for specific productive purposes on the collective security of all the members of the bank. They have played a valuable part in freeing the peasant from usurious interest rates. The latest available data show an aggregate of 3,500 such banks holding over 1,000 million lire in deposits and with outstanding loans for 700 million lire.

In 1913 the Istituto Nazionale di Credito por la Cooperazione (National Bank of Coöperation) was founded as a public utility bank under Government auspices, with a Treasury endowment and a capital of L. 220,960,000 subscribed by the Savings Banks, the Social Insurance Funds, etc. Its purpose was to act as a central bank for coöperative credit institutes and to finance coöperative associations for production, consumption and building. Reorganized in 1925 under the name of National Bank of Labor and Coöperation it has extended its field of activities to cover non-coöperative agricultural credit and to finance colonial enterprises.

JOINT STOCK BANKS

Italian joint stock banks deal in (a) *commercial credit;* (b) *industrial credit;* (c) *credit guaranteed by long-term securities* such as industrial shares and bonds, etc.

LEGAL STATUS OF BANKS. Prior to 1926 the only legal provisions regulating joint stock banks were those of the commercial code. In that year two decrees were enacted requiring the consent of the Minister of Finance for amalgamating existing or opening new main or branch banks. Banks operating on a national basis must have a capital of not less than 50 million lire, regional or zone banks a capital of not less than 10 million and those operating in a single province not less than 5 million. The ratio between capital and deposits and the maximum credit assignable to one customer are prescribed, and all such banks are placed under the supervision and inspection of the Bank of Issue. Foreign banks desirous of opening branches in Italy obtain the preliminary permission of the Minister of Finance who in granting such permits takes into account the reciprocal treatment afforded to Italian banks in the country to which the applicant belongs.

A copy of the statutes of joint stock banks must be deposited with the Court in the town in which each has its headquarters, and the statutes are only valid when they have been approved by the Court.

ADMINISTRATION. The general meeting of stockholders is the chief governing body of deposit banks. It is convened once a year on the publication of the balance-sheet of the previous business year. Special meetings may be summoned to consider proposals for increasing or writing down the capital stock, prolonging or terminating the period for which the bank was established, amalgamation, change of headquarters, etc. The general meeting is called by the Board of Directors. Shareholders who wish to take part in the meeting must deposit their shares with a bank specified in the notice of convocation. The quorum required for the validity of the proceedings varies from one-fifth to one-half of the total number of shares. A special quorum is required when action has to be taken on vital points. The resolutions taken by the meeting must be sent in to the Court within eight days of the meeting.

The Board of Directors is elected by the general meeting, and is the chief executive organ of the bank. Its numbers vary from 15 to 20. They must give security by depositing with the bank a certain number of shares. They are paid by attendance fees and by a percentage of profits. Their term of office varies from two to four years, and may be removed.

The Managing Director is empowered to discharge all the business authorized by the statutes; for a few matters of special importance the approval of the Board is required.

The Auditors supervise the work of the bank on behalf of the shareholders' meeting. They are present at Board meetings and may ask that a special general meeting be held. They inspect the books of the bank at its several seats and branches, and present a joint annual report to the general meeting. Their number varies from three to five.

The business transacted by joint-stock banks, notably by the four leading Italian deposit banks, the Banca Commerciale Italiana, the Credito Italiano, the Banco di Roma, and the Banca Nazionale di Credito, covers the following items:

Deposits. Deposits are the chief resource of the Banks. They may be "on call," or "on time." Deposits may also be made for fixed periods, or in the form of current accounts tied from one month end to another. These are used by merchants and manufacturers. Evidence of such deposits is afforded by interest-bearing certificates registered in the name of the depositor, or made payable to order or to bearer, in which the bank agrees to refund the deposit on the expiration of the period agreed on.

Deposits on Current Account are received and check books issued. They can be drawn on at call or at brief notice.

Small Savings Deposits are an important branch of business with the less important banks. Deposits are received for very small amounts, withdrawable on call or on short notice. The interest paid on such deposits is slightly above that paid on ordinary deposits.

Interest Bearing Deposits of Securities. Gilt-edged and readily negotiable securities such as Government stock are received as interest-bearing deposits. The bank reserves the right to use them freely as collateral for advances and settlement transactions with other banks, to secure liquid funds.

Issue of Bonds. Joint stock banks can issue long-dated interest-bearing bonds retired by drawing by lot. They are issued below par, and under normal conditions their value rises as the date for drawing and retiring at par approaches.

Rediscount. Small banks procure themselves funds by selling their bills to the big banks which in their turn rediscount them with the Bank of Issue. The transaction indicates that the bank's own resources are inadequate to meet its needs.

Acceptances. The joint stock banks accept bills in their own name and on behalf of customers, generally on the international market, substituting themselves for the customer in his dealings with foreign banks or the big national banks. The collateral given for acceptances is merchandise represented by bills of lading, insurance policies, invoices, etc. Such transactions are generally preliminary to the opening of current accounts, discounts, etc.

Discounts. These are generally for periods of 3 or 4 months, mostly on commercial paper, bills, and checks, but also on Treasury bills, coupons not yet matured, interest-bearing certificates, warehouse warrants, etc. The discount rate is determined by market conditions; frequently two rates rule, that of the Bank of Issue, and that of the great deposit banks. The discount market is, however, controlled by the Bank of Issue; for as soon as the probability of large withdrawals arises the deposit banks have to discount their bills with the Bank of Issue and they then have to charge the official rate and not infrequently a higher one. In June, July, and August the need of money is limited and the discount rate tends to fall; it tends to rise in September, October and November when large payments fall due for wool, cotton, and cereals and when the wine crop has to be financed, so also in December when annual settlements fall due.

In Italy the official bank rate is generally lower than that of the deposit banks. The official rate was last changed in June, 1928, when it fell from 6 to 5½ per cent.

Nature of Business. Data are not available on the nature of the discount business of the leading banks as they do not classify their portfolio holdings but bulk together Treasury bills, commercial and other paper, sometimes even property deeds. Some idea of its importance is afforded by the figures showing bills, etc., held

on December 31, 1925, their percentage to total assets, and profits earned on discounts:

	Bills etc. (millions of lire)	% of total assets	Discount profits (millions of lire)
Banca Commerciale Italiano ...	4,380	29.6%	204
Credito Italiano	2,766	28.3	190
Banco di Roma	700	28.5	3
Banco Nazionale di Credito	940	30.6	46

Credits on Open Account. These are loans made by the banks entitling the borrower to draw the amount at a fixed date in one or more installments. The interest charged is always 1 to 2 per cent higher than the bank rate as the risk is greater than for loans on commercial paper which can be recovered under the summary proceedings for the settlement of liabilities on bills. As a rule the bank has the right to recall the loan in full or in part at any time. It may be secured by a general lien on all the borrower's assets, or by specific collateral, such as property pledged, mortgages or personal security.

Advances on Securities. These are made by the banks on government stock certificates, municipal and provincial bonds, land credit certificates, and similar gilt-edged securities. Advances may be for stated periods or on current account; the interest is fixed for each transaction. The bank provides against the risk of depreciation of the securities by leaving an ample margin for discount and by a clause in the agreement requiring the borrower, in case depreciation should exceed, as a rule, 10%, to refund the difference or to deposit a larger number of securities. A declaration is required transferring the ownership of the securities to the bank until the liability is discharged; in case of default the bank can sell them through a broker or by public sale and repay itself from the proceeds. If the bank has its own storerooms it may store goods and make advances, open lines of credit, discount bills, etc., against their value as determined by valuation. It is however more usual to make such loans against warehouse warrants.

Advances on Floating Cargoes. These are unusual and only made in ports frequented by sailing vessels. They consist in loans made to the skipper or shipowner on the security of cargoes to be paid when the ship reaches the port of delivery.

Letters of Credit. These are issued by a bank crediting a customer to another bank for a given amount. Such letters are not negotiable. The bank receives a commission on the amount credited.

Brokers' Loans. The Commercial Code defines such transactions as "an agreement to make spot purchase of credit securities in current circulation and to resell on term securities of the same description for a fixed price to the same person from whom they were bought." The agreement differs little from that for advances on securities, except that during the interval between spot purchase and term sale the securities become the property of the bank. At the date agreed on the seller to recover the securities must refund the sum he received plus the interest on same (contango rate) which varies with the securities and with market conditions.

The taxation on brokers' loans and on advances differs; there is no time limit placed on the latter, whereas the former may not exceed 40 days. Should a brokers' loan be prolonged beyond that period it is taxed at the same rate as advances on deposit or pledge.

Deliveries. The term-purchaser can always require the delivery of the securities involved in such transactions prior to the agreed date on payment of the price arranged, but he cannot exercise this right during the 6 days preceding those of settlement on the Exchange. The banks invest large sums in brokers' loans, as shown by their balance-sheets on December 31, 1925.

Banca Commerciale Italiana	586	million	lire
Credito Italiano	401	"	"
Banco di Rome	254	"	"
Banca Nazionale di Credito	109	"	"

A strong current of opinion in Italy advocates the prohibition of this business, as it lends itself to stock exchange manoeuvres. A restriction was placed on it by the decree of April 15, 1924, empowering the Ministry of National Economy to suspend the enforcement of agreements dealing with shares of banking companies or partnerships. Similar to those just described are the transactions in which the bank obtains the securities and the customer does the spot purchase and term sale.

Securities. Banks may invest their capital both in industrial and public securities, and Italian banks do so invest a large portion of the savings intrusted to them. On December 31, 1925, the item " securities held " was as follows:

Banca Commerciale Italiana	377 million lire
Credito Italiano	234 " "
Banca Nazionale di Credito	153.8 " "
Banco di Roma	185 " "

Such investments are made for various purposes. They may be made as a permanent investment of capital; or with a view to introducing certain securities on the market and gradually disposing of them, more especially in the case of shares or bonds issued by companies of recent formation in which the bank is interested; or such purchases may be made as a speculation when the price is low to be resold when it rises.

Participations. Banks also invest part of their capital by participating in the productive activities of Companies and Corporations. Such participation may take the form of (a) *share issues:* When companies are formed, or amalgamate, or increase their capital, the bank issues shares in their name, or underwrites issues of consolidated or floating debt; (b) *purchase:* the Bank purchases a block of securities not yet placed on the market by the issuing company or corporation; (c) *flotation:* a banking syndicate raises the price and creates a demand for weak shares by making large and timely purchases on the market so as to reanimate it; (d) *management:* the banks may take over the management of big industrial and commercial concerns whose technical direction remains independent, or they may become sleeping partners, financing the concerns.

Foreign Portfolio Transactions. These consist mainly in the purchase and sale of foreign valuta, that is to say in the negotiation of credit instruments. The banks take advantage of the varying rates of exchange to trade in drafts and remittances (arbitrage).

GROWTH OF JOINT-STOCK BANKING FROM 1870 TO 1914

Although historically banking first developed in Italy — the name given to the famous street of bankers in London, Lombard

Street, is illustrative of this — modern banking in Italy only dates back to 1870. That banking activities began at once to develop vigorously in the newly United Kingdom of Italy is evidenced by the fact that the number of banks rose from 33 in 1870 to 124 in 1873, while their nominal capital rose from 190 to 760 million lire in the same period. Discounts quintupled, advances tripled. The coöperative Peoples' Bank, the land and agricultural credit banks, and the Savings Banks started on their promising careers in those years.

The ups and downs of Italian financial and monetary policy which ended in the crisis of 1893 affected the life of the banks. Indeed, the ill-regulated banking system was a contributory cause of that crisis, more immediately due, however, to the agricultural depression in the South which the banks endeavored to relieve by overloading themselves with second and third rate commercial paper; to the building crisis in Rome which ruined some banks engaged in financing such operations on a large scale; to the monetary and economic crisis. The Government encouraged the six Banks of Issue to come to the rescue. The note circulation was increased; the banks held huge lots of worthless commercial paper; depositors clamored to withdraw their funds; and the refusal of foreign credits increased the difficulties of the situation. The Credito Mobiliare had to pay out 10 million lire in a fortnight, the Società Generale di Credito Mobiliare saw 60 million lire of foreign credits go up in smoke.

Depression of 1892–3. In 1892 the Banca Romana failed; in 1893 the Banca Generale with a capital of 30 million lire and the Società Generale di Credito Mobiliare with a capital of 60 million lire, went the same way. These banks obtained a moratorium and the losses were not heavy. The Government came to the rescue by reorganizing the banks of issue.

In 1894 symptoms of an economic revival were noted and the Banca Commerciale Italiana was established to liquidate the Società Generale di Credito Mobiliare.

In 1895 national economic recovery began. During the years immediately following the crisis three great banks came to the fore: the Banca Commerciale Italiana, the Credito Italiano, an outgrowth of the Banca di Genova founded in 1870, and the Banco di Roma founded in 1880. These banks started with a

policy of protecting and favoring the growth of Italian manufactures and trade.

With the opening of the twentieth century the discount business of the banks grew apace with the new industrial growth, especially of the textile, electrical, and metal trades.

Banking underwent a marked change of policy. Formerly many complained that the leading Italian industries received practically no support from the banks; but with the advent of the Banca Commerciale Italiana as a financial star of the first magnitude Italian banking developed on German lines. Soon all the banks, large and small, were contributing under a well-organized system of personal credit, to promote industrial development. This change in policy accounts for the great increase in the number and capital of joint stock companies in Italy. In 1900 there were 848 such companies with a capital of L. 2,212,182,262, engaged in a variety of profitable undertakings, as against a bare 574 with a capital of 1,600 million lire in 1890. At the end of 1926 there were 12,019 companies with a capital of 40,317 million lire.

The financial reactions of the Boer War, the American crisis, and " bull " speculation following on the conversion of the Italian funded debt, reacted on the Italian business situation in 1907. The latent crisis was, however, avoided, as is clearly shown by the discount business of the Banks of Issue which rose from 626 million lire in 1906 to 753 million in 1907 and swiftly dropped to 549 million in 1908. A higher bank rate and the temporary introduction of a discount fee to discourage speculation on the stock exchanges were the means used to save the situation.

Effects of Italian-Turkish War. The Italian-Turkish war in 1911 again caused trouble. Increased government expenditure led to some inflation of the currency and to a large issue of five-year Treasury bonds. But the industrial situation continued normal and satisfactory in almost all branches. The growth of joint stock companies was slow, and in the absence of private investors they were financed almost exclusively by the banks. The banks proceeded on profitable and normal lines, if we take normal banking to consist in the collection of savings in their several forms and their orderly investment with due regard to the length of the liability incurred. It cannot however be denied that the

banks were even then compelled by Italian economic conditions to participate, perhaps to an excessive degree, in industrial enterprises. It must not be forgotten that in this period of normal monetary conditions, international reactions in the economic sphere were immediate and the conditions prevailing in one country affected in a marked degree those existing in another. Internationalism in the economic sphere was a concrete fact, and the great banks operated not only on the Italian but also on other European markets. The close interdependence of the European banks was one of the causes which intensified the effects of the war.

Status at Opening of War. At the close of 1913 there were 114 banks in Italy with a capital of 550,753,297 lire; deposits amounted approximately to 1,500 million lire; with one exception they all reported profits, amounting to a total of some 50 million lire. The three leading joint stock banks, the Banca Commerciale Italiana, the Credito Italiano, and the Banco di Roma held a capital of 405 million lire and reserves of 66.5 million, a ratio of 16.4% of their capital. The remaining 111 joint stock banks held 144 million lire capital and 58 million lire in reserves, a ratio of 42.6%. The three leading banks held 584 million lire in deposits; the other banks around 900 million lire.

These figures show that although the three large banks accounted for nearly four-fifths of the total capital, they only held a little over half the total deposits. The other items on their balance-sheets also show that the large banks are far from possessing that superiority over their lesser colleagues which they boast in the matter of share capital. As a consequence the return on capital stands at 12% for the small and at 7.22% for the large banks.

BANKING IN THE LAST DECADE

The outbreak of the European war caused a panic among depositors which was met by a moratorium. The banks of issue came to the assistance of the joint stock banks, affording them by rediscounts the means to meet the claims of depositors.

At first the country experienced a phase of industrial and trade depression, followed by a business revival when Italian factories worked to meet the needs of the belligerent countries.

During this period of readjustment to changed circumstances deposits were reduced, and so were the opportunities for investment usually available for such savings, as cash payments had taken the place of credit. As soon as the country was reassured and capital again became available, two forms of investment were open to the banks — a prudent, liquid, reasonably profitable investment was afforded by the purchase of Treasury bills issued by the Government to meet its ever growing needs; on the other hand the steady growth of the munition industries afforded opportunities for investing capital in new plants and in credits for working expenses. The large banks undertook to finance these industries by opening credit accounts in their behalf.

The banks of issue, more especially the Bank of Italy, had to meet the needs of the situation by placing themselves at the service of the Treasury, by discounting the bills of the deposit banks, and by increasing the advances made to them.

When Italy entered the war her economic and financial system had already adjusted itself to the new conditions. The increasing needs of the Treasury led to further inflation, and debts in the shape of loans and Treasury bills grew apace. War needs accelerated the growth of industry, and gradually all the activities of the country were coördinated toward the one aim of self-preservation.

Banca Italiana di Sconto Founded. In the fall of 1914 the Banca Italiana di Sconto was founded with a capital of 15 million lire, almost immediately raised to 70 million by amalgamation with the Società Bancaria Italiana and the Società Italiana di Credito Provinciale. The abnormal conditions prevailing at the date of its foundation were not without influence on its subsequent failure.

In 1915 the deposit banks began to adjust themselves to the growing needs of war economy. This is indicated by the return to normal of the discounts of the banks of issue to which the deposit banks no longer had recourse for rediscounts; another symptom is the increase in profits which rose from 7.17% in 1914 to 10.25% in 1915, as a result of the higher discount rate and the new munition activities.

The Consortium for Subventions on Industrial Securities was formed as an agency collateral to the banks of issue, completing

the circle of banking institutions making advances on securities and discounting commercial paper and warrants.

During the period 1915–25 the number of banks doubled and the growth of their subscribed capital proceeded *pari passu* with the inflation of the currency.

Munition industries, centered round the *Ilva* and the *Ansaldo*, needed large credit which the banks supplied, engaging all their resources. As a result the item " discounts " diminished on the balance-sheets of the smaller and showed a 30% increase on those of the larger banks.

Inflation began to make its effects felt in 1916; the smaller banks increased in number and their capital grew, but their discounts continued to decrease until 1917. On the other hand the item " securities " grew steadily with the large subscriptions to war-loans and the wholesale purchase of Treasury bills.

In 1918 the discount business of these smaller banks increased and grew by leaps and bounds in the ensuing years. This was partly due to heavier inflation, but more especially to the new tendency for such banks to act as subsidiaries to the big deposit banks.

At the beginning of the war deposits had flown by preference into the coffers of the banks of issue and into those of the smaller banks. They now returned to their normal channels and grew much more rapidly with the big than with the small banks, expanding with the expansion of business activities.

Discount Item in Balance Sheets. On the balance-sheets of the banks of issue the item " discounts " again grew as a result of inflation; " ordinary advances " showed a substantial increase, for as the interest rate on Treasury bills was higher than that on " advances " the banks found it profitable to invest in the purchase of bills subsequently obtaining advances on them from the banks of issue; " deposits " showed but slight variations due to the fact that the big banks had doubled the number of their branches in 1919 as compared to 1914.

Economic and industrial demobilization brought the big banks up against great difficulties. They continued to subsidize industries to help them over the transition crisis.

An examination of the balance-sheets of the banks of issue in

1920 shows similar changes to those which occurred at the beginning of the war. Discounts more than doubled, advances almost doubled. The business done by the Consortium for Subventions on Industrial Securities increased threefold.

The big banks marked time as the crisis approached. Their reduced activity was countered by a revival of the activities of the smaller banks whose number increased at the same rate as in previous years while their discounts, advances, and brokers' loans doubled in a twelvemonth and their deposits increased by 150%.

Failure of Banca di Sconto. The crisis came in 1921 with the failure of the Banca Italiana di Sconto. The failure of this bank which in five years time had outstripped even the Banca Commerciale Italiana, was due to the assistance it had given to war industries, and more especially to the Ansaldo group. Its failure naturally reacted on the deposits placed with the others; to meet the calls made on them the deposit banks again had recourse to rediscounts and advances made by the Banks of Issue. The balance-sheets of the smaller banks showed an increase for all items, which, if less marked than in previous years, was nevertheless in marked contrast with the corresponding items in the balance-sheets of the big banks.

In 1922 the figure for discounts of the Bank of Italy continued to increase, mainly owing to the rediscount of bills held by the Consortium for Subventions on Industrial Securities. In the case of the big deposit banks this item was stationary; while it declined in the case of the smaller banks whose deposits however increased while those of the big banks declined.

Italian banking made a good recovery from the grave crisis caused by the failure of the Banca Italiana di Sconto, and in the ensuing years it has set to work to consolidate its position and to facilitate the economic transition from war to peace conditions. The joint stock banks turned their energies into safer channels and persisted in their policy of liquidation. In its policy of revaluation and deflation the Fascist Government has had the disciplined support of the banks.

Deflation, undertaken at a time when the banks were still engaged in liquidating their credits, naturally led many to fear that a widespread industrial and economic crisis was inevitable. But although the banks have had to make considerable sacrifices this

has not occurred and severe depression has been limited to certain branches of industry.

EFFECTS OF DEFLATION. The depressing effects of deflation have been minimized by the policy of the Fascist Government favoring a wise distribution of credit, on lines which have relieved the pressure on industry and trade, enabling business to keep going on fairly normal lines; and the influx of capital secured by foreign loans, amounting in 1927 to 303 million dollars and 1,500,000 pounds sterling, has eased the situation.

The following figures for the ten Italian clearing houses reflect the growth of banking activities:

	Checks etc. cleared	Difference settled as percentage of total
1913	65,622 million lire	7.1%
1926	1,297,535 " "	3.5%
1927	768,107 " "	2.9%

The organization of Italian banking is gaining in strength under the direction of the Bank of Issue, and fitting itself to respond more fully to the needs of Italian economic life which calls for intensified production in agriculture and industries to meet the steady growth of population.

CHAPTER XI

THE BANKING SYSTEM OF JAPAN

BY

Tadao Wikawa [1]

A BRIEF HISTORY OF BANKING IN JAPAN

Banking in the Feudal Ages. During the feudal ages there were a number of institutions in Japan engaged in a sort of banking. Most of these were under the management of individuals similar to the private banks still in existence in Europe and America; some belonged to guilds or unions. Their business was carried on chiefly in connection with the financing of either the Government or of the feudal lords' families, with little consideration for the general welfare of the whole people.

By the restoration of 1868 the sovereign power, which for nearly three hundred years had actually been held by the Tokugawa Shogunate, was restored to the Imperial family. This put an end to the feudal system and abolished all social castes. A severe blow was given to these banking institutions by this radical change, accompanied as it was by civil wars, and by great changes in political as well as social life. The financial structure of the rejuvenated nation consequently was thrown into chaos.

The Dawn of Modern Banking. The Restoration Government lost no time in modernizing the banking system. In the principal business centers, there were established so-called " trade companies " and " exchange companies," the former aiming at the promotion of domestic and foreign trade and the latter, at the facilitation of their financing. The first exchange company which was founded in 1870 was along Western lines.

Adoption of the National Bank System. With the promulgation of the National Bank Regulations in 1872 modelled

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after the National Bank Act of the United States of America, practically all of these companies were absorbed into the new system, beginning with the establishment in 1873 of the First National Bank. As a result of an amendment of August, 1876, the national bank notes, hitherto convertible, became actually inconvertible, and apparently to the great profit of the banks. This so strongly stimulated the formation of national banks, that by 1879 the total of their note issue reached the maximum set by the Government. Their establishment thereafter was prohibited.

Termination of the National Bank System. Excessive issues of national bank notes, coupled with those of Government paper money, seriously disturbed, as was to be expected, the financial organization of the nation. As a result of this chaos, the necessity for the centralization of the note issue privilege was quite fully realized by the authorities.

As a result in June, 1882, the Bank of Japan regulations, modelled chiefly after those of the German Reichsbank system were promulgated. The establishment of the Bank of Japan was followed by the revision, in May, 1883, of the National Bank regulations, providing for the termination of the note-issuance power of the national banks with the expiration of their charters, which would lapse within twenty years. Thereafter they might continue in business as ordinary commercial banks, and some of them continued in this changed status by simply taking the word "National" off their trade names; such as, the First Bank and the One Hundredth Bank which were formerly the First National Bank and the One Hundredth National Bank.

Centralization of Note-issuing Power. Two years later, the Convertible Notes Regulations were issued. In accordance with these, the Bank of Japan in May, 1885, was given the sole right to issue bank notes. By an amendment in 1888, putting a limit on the fiduciary note issue, the cornerstone of the modern banking system was actually laid. Specie payments against the Government notes were resumed in January, 1886. The national bank notes had constantly been withdrawn, till at last by a law of 1896 their circulation was prohibited on and after December 9, 1899.

COMMERCIAL BANKING SYSTEM

In April, 1890, a modern Commercial Code was issued, which was later superseded by the new Commercial Code of March, 1899. This brought about a codification of the general banking laws, which took the form of the Ordinary Bank Regulations of August, 1890 (Law No. 72). The Regulations became effective on July 1, 1893, when the provisions of the Commercial Code also took effect. Consequently, those private banking institutions, remnants from the feudal age, finally disappeared, though some of them survived as so-called "ordinary banks" under the new system.

The number of ordinary banks in 1892 was only 323, and in the following year increased to 604. In 1897, the year of termination of the National Banking System, they numbered 1,305 with a total authorized capital of 232,313,114 yen. Since then their number and their total capital and business have on the whole steadily increased, though recently there is a tendency for their number to decline due to the nationwide movement for bank amalgamations which has the encouragement of the Government. The following table may give the reader a general idea as to the development of this particular class of banks.

At the end of	Number of Banks	Capital		Reserves	Deposits	Advances
		Authorized	Paid-up			
		(in yen, 000 omitted)				
1900	1,588	295,270	206,621	33,032	436,779	351,550
1910	1,448	386,795	280,702	101,333	1,185,697	1,257,412
1915	1,442	513,988	357,709	127,669	1,699,566	1,728,728
1920	1,326	1,603,117	963,572	267,403	5,826,526	5,902,962
1921	1,331	1,703,054	1,044,586	339,073	6,444,836	6,242,034
1922[2]	1,799	2,366,284	1,450,227	493,386	7,801,459	7,848,182
1923	1,701	2,444,690	1,491,053	543,188	7,805,265	8,059,008
1924	1,629	2,437,684	1,507,750	585,229	8,093,167	8,289,138
1925	1,537	2,406,560	1,500,627	627,013	8,726,775	8,842,682
1926	1,420	2,384,957	1,500,216	663,054	9,178,802	9,219,798
1927	1,276	2,378,219	........[3]	......[3]	8,906,473	8,122,926

[2] The year the new Savings Bank Act became effective, by virtue of which many so-called savings banks changed into ordinary banks.

[3] Data not yet available.

SAVINGS BANK SYSTEM

The year 1893 marks another epoch in the banking history of the nation on account of the promulgation of the Savings Bank Regulations. The modern savings bank system, hand in hand with the Government postal savings bank system, plays an important rôle in the financial organization of Japan. As the following table indicates, the system has shown a steady growth since its inauguration. The sudden shrinkage in 1922 is due to the new Savings Bank Act, which eliminated all those savings banks that had actually become commercial banks.

At the end of	Number of Banks	Capital Authorized	Capital Paid-up	Reserves	Deposits	Advances	Investment
		(in yen, 000 omitted)					
1893	24	1,140	567	591	6,035	3,421	2,123
1910	646	135,872	87,758	70,397	277,683	171,863	88,806
1920	661	521,814	320,308	92,658	1,843,000	1,597,592	380,151
1922	146	83,681	33,659	15,549	651,245	185,982	305,511
1925	133	90,021	37,647	23,962	904,605	191,881	526,650
1926	124	97,941	41,138	27,414	1,067,551	264,675	603,658
1927 June	113	97,245	......[4]	.....[4]	1,083,098	269,576	......[4]

[4] Data not yet available.

The postal savings bank system was introduced in Japan by the Government in 1875, simultaneously with the introduction of the postal money order; both modelled after the British and Belgian systems. The system falls under the jurisdiction of the Minister of Communications, with several Director Generals under him held responsible for the supervision of depositors' ledgers, etc. Deposits may be made in cash, postage stamps, or public loan bonds. At present the minimum for a single deposit is set at 10 sen, that is, one tenth of 1 yen, and the total maximum of one person's deposit is 2,000 yen. Some exceptions are made, however, of this maximum; such as deposits of public institutions, coöperative societies, and deposits for postal transfer accounts. Again, the above limit is waived even to an ordinary depositor to the extent of his purchase of public loan bonds, etc., through the postal savings banks.

The postal transfer system was established on March 1, 1906, the year of its adoption in Switzerland, and was modelled chiefly after the Austro-Hungarian system. Its conveniences have gradually been appreciated by the public and its sphere of activities extended immensely; for instance, to the receipt of taxes, assessments and other dues, the payments of the Government pensions, and of principal and interest on public loan bonds.

At the end of	Outstanding Amount of		
	Postal Savings Deposits	Postal Transfer Accounts	Total
	(in yen, 000 omitted)		
1897	26,335	.....	26,335
1907	91,531	2,553	94,084
1917	416,947	21,771	438,718
1920	847,003	36,080	883,083
1925	1,136,593	39,253	1,175,846
1927	1,523,037	42,935	1,565,972

SPECIAL BANKS

In addition to these two systems of banks, there is still another type of great importance. They are ordinarily termed " special banks," as they are specially chartered with specific purposes and functions and created by special legislation.

The Central Banks. At the very top of this class stands the Bank of Japan, the bank of banks throughout the Empire. There are two other banks of a similar nature, though more or less limited in their sphere of activities. One of them, the Bank of Taiwan, created under the Bank of Taiwan Act of March, 1897, commenced business in September, 1899, with the purpose of promoting economic development in the Formosan Islands. The other is the Bank of Chosen, formerly called the Bank of Korea, established in October, 1909, with similar purposes for the Korean Peninsula. Both of them, with the note-issue privilege, are central banks for their respective territories.

Bank for the Financing of Industries. With the special object in view of financing industries, a special Act was promulgated in March, 1900, and in accordance with this law in April, 1902, the Industrial Bank of Japan was created. Its working funds are chiefly obtained by means of selling bank debentures to the public.

Bank for Agricultural Finance. The Hypothec Bank of Japan was established in August, 1897, under a special Act promulgated in April of 1896, for the purpose of making long-term real-estate mortgage loans. It serves chiefly as the central organ for agricultural finance. The bank is authorized to offer mortgage bonds to the public to obtain its working capital.

Local Banks for Financing Agriculture and Industry. Simultaneously with the passage of the Hypothec Bank Act, the Agricultural and Industrial Bank Act was promulgated. In accordance with this there was established between 1897 and 1900 a local Agricultural and Industrial Bank in every prefecture, totalling forty-six in all. Their purposes and functions are similar to their central organ, the Hypothec Bank of Japan, though they are more limited in their sphere of activities. With a view of affording further financial facilities to rural districts, a law providing for the amalgamation of these central and local organs was enacted in 1921, and has resulted in the gradual amalgamation of the latter with the former. These local banks also obtain their working capital chiefly by means of the flotation of mortgage bonds.

With the purpose of aiding agricultural and industrial development in the Korean Peninsula, the (Korean) Agricultural and Industrial Bank Regulations were promulgated as early as in March, 1906, when Korea was still a protectorate of Japan, in accordance with which a number of such banks were established. By the end of 1917 six head offices and forty-one branches had been established. The rapidly changing conditions in the economic life of Chosen, however, made it necessary to have a thoroughgoing reform in the financial organization. Finally, in June, 1918, the Industrial Bank of Chosen Act was promulgated, by virtue of which in October of the same year the Industrial Bank of Chosen was created, amalgamating all of the Industrial and Agricultural Banks then in existence.

Colonial Banks and Bank-Like Companies. In March, 1899, the Hokkaido Colonial Bank Act was promulgated, under which a bank was established in April, 1900. It has a specific purpose of affording financial facilities to the colonization and exploitation of Hokkaido, the northern island. Since the acquisition of the southern half of Saghalien Island (Karafuto) after the Russo-Japanese War, its sphere of activities was extended to this new territory. This bank is also authorized to sell its debentures to obtain its working funds.

The Oriental Development Company, chartered in October, 1908 in accordance with the Company's Act of August 27 of the same year (Law No. 63) was similarly organized for the economic development of the Korean Peninsula, though its scope of business has been extended by frequent revisions of the original Act. The Company is also one of those allowed to sell debentures for its working funds.

Bank for Foreign Trade Finance. There remains another special bank of great importance. It is the world famous Yokohama Specie Bank, founded as early as February, 1880, with the avowed purpose of fostering the overseas trade of Japan. Its establishment was in the nature of an emergency. The Government not only subscribed one-third of the capital but also gave it every kind of encouragement and protection. Unlike other banks of this group, a special act was passed in July, 1887, several years after its organization. The marvelous expansion of the foreign trade of Japan in the past half century owes much to the banking facilities afforded by this bank.

Peoples' Banks. There are three kinds of institutions of some importance in this sphere of finance.

The first is the so-called "mujin" or Mutual Loan Societies, founded upon mutual credit among the middle and lower classes of society. The legal status of these was recognized anew by the Mutual Loan Society Act, promulgated in June, 1915.

The second group are the city Credit Unions, having functions similar to those of Europe and to the Savings and Loan Societies of America. They acquired a legal status by the Coöperative Societies Act of March, 1900, and expanded their activities by virtue of the July, 1917 revision.

The third group are the companies engaged in the instalment

sale of securities; such as bonds, debentures and other negotiable papers. They are institutions of rather recent development, but of increasing importance in fostering the habit of thrift among the middle and lower classes and serving at the same time in a nation-wide distribution of securities. By an Act promulgated on April 1, 1918, effective September 1 of the same year, their legal status was recognized and their customers are protected by Governmental supervision.

The Central Chest for Coöperative Societies. With the steady growth of coöperative societies, it became desirable to have a central body for the purpose of regulating the movement of their funds, and bringing them into close touch with the central money market. It was for this reason that on April 6, 1923, a law called "Central Chest for Coöperative Societies Act" was promulgated. The chest is authorized to issue Industrial Bonds to obtain its working funds.

Trust Companies. Even so brief a history as this of the Banking System of Japan would not be complete unless a few lines were devoted to two types of institutions playing very important rôles in the financial organization of the nation. One is of recent development, while the other has been in existence for nearly half a century; the latter, comprising various kinds of insurance companies, the first of which was established in 1887, however, falls outside the scope of this study. The former, including trust companies of rapidly increasing influence in the modern economic life of Japan, have had but a brief existence.

Since the appearance in 1906 of the first company bearing the name of "trust company," their number has steadily increased, especially during and after the World War. There was, however, no specific code to regulate them, other than the general Commercial Code, Business Tax Act and the Secured Debentures Trust Act (Law No. 52, March, 1905). The enactment of a special trust companies law had become imperative, till at last on April 21, 1922, the Trust Act (Law No. 62) and the Trust Business Act (Law No. 65) were promulgated, both of which became effective on January 1, 1923. Some of the then existing companies acquired a new legal status in accordance with the Acts. Most of the trust companies of today are, however, of recent establishment. There were at the end of 1927, thirty-

seven trust companies with eleven branches. The total of their authorized capital was 333,500,000 yen of which 91,650,000 yen was paid in.

THE REVISION OF THE BANKING LAWS

General Remarks. Most of the banking laws of Japan, though amended several times since enactment, had become in time quite inadequate to meet the nation's new economic life, and especially those radical changes that took place during and after the World War. Their general revisions and hence reform of the national financial organization had become necessary.

The New Savings Bank Act. The forerunner to the movement was the new Savings Bank Act of 1921, which became effective on January 1, 1922.

The New Bank Act. In September, 1926, a commission, modelled after the National Monetary Commission of the United States of America, was created. It was named, literally translated, the Financial System Investigation Commission. The Commission immediately set to work. It put the problem of improvement in the commercial banking system to the fore and made several recommendations after thoroughgoing discussions. Based upon them, a bill was drafted and proposed at the Fifty-Second Session of the Imperial Diet (December, 1926 — March, 1927). It passed the Diet with little amendment and was promulgated on March 30, 1927 as Bank Act (Law No. 21). The date of the enforcement of the Act and its accessory laws was set for January 1, 1928, by Imperial Ordinance No. 326 of November 15, 1927. On the same date, three other accessory Ordinances were promulgated. Two days later the Detailed Regulations (Finance Department Order No. 31) to the Bank Act were promulgated, putting the new laws into effect and superseding the Bank Regulations of 1890.

The Financial System Investigation Commission has under consideration now the revision of the various Special Bank Acts as the next step, though it will take some time before it will be ready to make recommendations.

PRESENT BANKING SYSTEM OF JAPAN

Ordinary Banks. The "ordinary banks," or rather loosely, the commercial banks, are regulated by the new Bank Act, which is composed of forty-seven articles, ten of them being supplementary rules. Like corresponding legislation in the United States of America, they are rather strict. It may be said, however, that the new legislation has as its ideal the deposit banking system of England.

Definition of a Bank. According to the Article 1 of the Bank Act (hereinafter abbreviated as B.A.) a bank is an institution carrying on the following types of business: —

(1) The receiving of deposits and the making of loans or the discounting of bills.
(2) The buying and selling of bills of exchange.

The second paragraph of the article, however, provides an exception to the above general rule by allowing a bank to carry on a secured debenture trust business in accordance with the Secured Debentures Trust Act.

Article 5 of the Bank Act further allows a bank to undertake a safe deposit business and other subsidiary business incidental and usual to banking.

Organization of a Bank. A bank must be organized as a joint stock company (B.A. Art. 3). Before applying for a license, therefore, there must be a joint stock company properly organized in accordance with the provisions of the Commercial Code (hereinafter abbreviated C.C.)

Capital. The capital of a bank must be no less than one million yen. This minimum capital requirement is doubled in the case of a bank with its head office or branches in a district specified by an Imperial Ordinance (hereinafter abbreviated I.O.) relative to the Act (B.A. Art. 3). The two large cities of Tokyo and Osaka were designated as such districts (I.O. No. 327, Nov. 16, 1927). Five years' grace, however, is granted to those banks with a capital below the minimum, having on the enforcement date of the Act their head offices or branches in such districts. There is another exception to the above general rule. Any bank

having on the above date its head office in a community of less than 10,000 population (based on the latest census return) has five years' grace in which to raise its capital to half a million yen, this being a special minimum requirement (B.A. Art. 41).

TRADE NAME. A bank has to use as part of its title not only the words "Joint Stock Company" (C.C. Art. 17), but also words indicative of a bank, the use of which is prohibited to other institutions than a bank (B.A. Art. 4).

A LICENSE ESSENTIAL. The business of banking cannot be carried on without a license from the Minister concerned (B.A. Art. 2), who is at present the Finance Minister (Finance Department Organization Ordinance Art. 1).

Having properly organized a joint stock company in accordance with the provisions of the Commercial Code, a written application, signed by all the directors, must be submitted to the Finance Minister, together with the following papers (the Detailed Regulations for Enforcement of the Bank Act — hereinafter abbreviated D.R.E. Art. 1): —

(1) Articles of Association.
(2) Certification of the required subscription for shares (C.C. 123, 125, etc.)
(3) The application form of subscription for shares; list of subscribers and their addresses and the number of shares subscribed by them (C.C. 126).
(4) Reports of directors' and auditors', or inspectors' investigations, and any other accessory papers thereto.
(5) The copy, in case a judgment has been given by the Court of Justice on the Inspectors' report (C.C. 124).
(6) In case directors and auditors have been elected by the promoters, papers concerning them (C.C. 133).
(7) Minutes of the resolutions at the inaugural meeting.
(8) Location of branches and other business places to be established at the time of incorporation.
(9) Daily statement on the preceding day of application.
(10) Certificate of the depository on the deposits of the incorporating company.

In case an already established business corporation intends to change its object of incorporation and carry on a banking busi-

ness, the following papers must accompany a written application (D.R.E. Art. 1): —

(1) Articles of Association.
(2) Copy of registry of the company.
(3) Daily statement on the date preceding the date of application.
(4) Papers showing the nature of transactions existing at the time of the application.
(5) The latest inventory and balance sheet (cf. C. C. Art. 78, 220, 225).
(6) Papers showing the latest profit and loss account and disposal of profits.
(7) List of shareholders, with the number of the shares held by them.
(8) In case there is any branch or other business place, papers giving its location.

In case any bank fails to commence its business within six months from the date of license, the license automatically becomes void, unless for unavoidable reasons the Finance Minister's permission has been obtained in advance (D.R.E. Art. 2).

When a bank commences its business, it must notify without delay the Finance Minister (D.R.E. Art. 3).

Sanctions Required. The Minister's permit is required in the following cases: —

(1) To establish branches and other business places or agencies.
(2) To change their location.
(3) To change business places other than branches into branches.

In the above cases a written application must be filed with the Finance Minister, accompanied by the following papers (D.R.E. Art. 4): —

(1) Statement of reasons.
(2) Minutes of the resolutions at the shareholders' general meeting.

(3) The latest daily statement, in the case of the establishment of a branch.
(4) Contract of agency, in the case of establishing an agent.

The above permit, if not exercised within six months from the date of issue, automatically becomes void, unless for unavoidable reasons the Finance Minister's permission has been obtained in advance (D.R.E. Art. 5).

In case a bank intends to go into voluntary liquidation, the Minister's sanction is required (B.A. Art. 25). In the case of the abolishing of a branch, detached office or agency, mere notification is required, together with papers stating the date of such abolition, reasons therefor and measures taken for the deposits (D.R.E. Art. 16). Business policy subsidiary to an agency or sub-agency are prohibited.

Holidays and Business Hours. Bank holidays are limited to national holidays, Sundays and other holidays generally observed in the localities, wherein a business place of the bank is situated. (B.A. Art. 18; I.O. No. 25, 1927). In case a bank closes its business on account of catastrophes or other unavoidable events, it must without delay advertise this fact; and local governors must be notified thereof (B.A. Art. 18).

As a general rule banking hours are from 9 a.m. to 3 p.m., though of course they may be prolonged at the convenience of a bank (D.R.E. Art. 13). In case a bank intends to shorten the statutory banking hours on account of local circumstances, the Finance Minister's sanction is required (D.R.E. Art. 13).

Suspension of Payment. In case a bank generally suspends the repayment of deposits without proper legal reason, it must without delay advertise this fact and notify the Minister concerned, setting forth a statement of the reasons (B.A. Art. 19). At the earliest possible date after such notification, the following papers must be filed with the Finance Minister (D.R.E. Art. 14).

(1) Statement of the day preceding the date of suspension, together with a statement of the various kinds of deposits.
(2) Written statement of the details leading to the suspension.
(3) Statement on the contents of assets and liabilities.
(4) Written statement relative to the measures or policy to be taken towards the repayment of deposits.

Alteration of Title and Capital. For the alteration of the trade name a sanction of the Minister concerned is required (B.A. Art. 6). A written application, together with a statement of the reasons and minutes of shareholders' general meeting, must be submitted to the Minister.

A sanction from the Minister concerned is also required for any change in the amount of capital (B.A. Art. 6). Accompanied by the following papers, a written application therefor must be filed with the Finance Minister (D.R.E..Art. 4).

(1) Statement of reasons.
(2) Minutes of the resolutions of the Shareholders' General Meeting.
(3) In the case of a capital increase, the latest daily statement.
(4) In the case of a capital decrease, the following papers are required (D.R.E. Art. 12, Sect. 4 and 5).
  (a) Income statement and balance sheet made within two weeks from the date of resolution thereon (cf. C.C. Art. 220, 78).
  (b) Papers showing that the advertisement and notification in order to give the creditors a chance for protest have duly been given (cf. C.C. Art. 220, 78).
  (c) Papers showing that notification for consolidation of shares has duly been given (cf. C.C. Art. 220½).

The sanction, not exercised within six months from the date of issue, becomes void, unless for unavoidable reasons the Finance Minister's permission has been obtained in advance (D.R.E. Art. 5).

Prohibition of Other Occupations and Subsidiary Business. Directors and managers actually in charge of the daily business of a bank are prohibited from engaging in the business of any other company (including a bank), without the sanction from the Minister concerned (B.A. Art. 19).

A written application must be filed with the Finance Minister, accompanied by the following papers (D.R.E. Art. 11).

(1) Statement of reasons.
(2) Personal history of the person desiring to engage in such other business.

(3) Explanation of his manner of conducting his daily business in the bank and of the business he intends to do in the other corporation.
(4) Articles of Association, latest business report, balance sheet, profit and loss account and other papers in sufficient detail to show the business, assets, profit and loss conditions of the other corporation.
(5) Statement with respect to the type of business conducted between the bank and the other corporation.

Subsidiary businesses allowed to be carried on by a bank must be ancillary to banking, such as the safe deposit business, the collection of bills, the guaranty of others' debts, the receipt and disbursement of money, the exchange of money, the buying and selling of securities, etc.; but such subsidiary or allied business must be so conducted as to be subordinate to the banking business.

Auditor's Duties and Report. Auditors must prepare twice in a business year a report on the result of their auditing with respect to the assets and conditions of the bank, and file it with the head office of the bank (B.A. Art. 12). Such should be done quarterly within one month after the close of every quarterly business term, conforming to the forms prescribed by the Detailed Regulations (D.R.E. Art. 10).

The Bank Act and its accessory regulations have no specific provisions with respect to the reserve for the payment of deposits and restrictions imposed upon investment of funds, granting of credits, etc., leaving this entirely to the good judgment of bankers.

Legal Reserve and Other Requirements. At every declaration of dividends a bank must set aside one-tenth of its profit as a reserve, until its total equals the capital (B.A. Art. 8). This is an exception to the general rule with respect to the legal reserve of corporations, which have to set aside at every declaration of dividends one-twentieth of their profit, until the legal reserve reaches one quarter of the capital (C.C. Art. 194).

An accounting must take place for each business year of a bank, which is prescribed to be half-yearly, that is, from January to June and from July to December (B.A. Art. 9).

For every business year a report must be filed with the Minis-

ter concerned. It must consist of a statement on business conditions, balance sheet, profit and loss account, reserves and dividends and a detailed statement with respect to the reserve for repayment, conforming to the forms prescribed by the Detailed Regulations. The report must be submitted within one month from the end of every business year (D.R.E. Art. 8).

A balance sheet for every business year must be prepared and advertised (B.A. Art. 11). It must be in the same form with the one constituting a part of the report to be filed with the Minister (D.R.E. Art. 9). In the advertisement the names of all the directors and auditors must appear (D.R.E. 9). The advertisement must appear in newspapers.

Bank Amalgamations. Generally speaking, there are two kinds of bank amalgamations. One of them is accomplished by means of the purchase by one bank of others; and the other, by the consolidation of banks, which may be subdivided into two cases, first, what is technically known to the common law as a consolidation, viz. — the creation of an entirely new bank and the dissolution of all others concerned, and second, what is technically known to the common law as a merger, viz. — the absorption by one bank of the other dissolving banks.

So far as banks are joint stock companies, their amalgamation is completed by going through all the procedure prescribed in the Commercial Code. A consolidation of banks, however, is not valid until a sanction is given by the Minister concerned (B.A. Art. 14); though to facilitate the amalgamation from a standpoint of strengthening the nation's banking system the new Bank Act provided several liberal exceptions to the general procedure prescribed in the Commercial Code. The notification to be given to the creditors in the case of corporations amalgamating in accordance with Article 78 of the Commercial Code is not required to be given the depositors of amalgamating banks (D.A. Art. 15) and both the two months' period for advertisement and notification in accordance with paragraph 2 Article 78 of the Commercial Code and the three months' period for assignment of shares with the purpose of their consolidation in accordance with Article 220½ of the Commercial Code, may be shortened to one month in the case of the amalgamation of banks (B.A. Art. 16).

A written application signed by all the directors must be filed

with the Finance Minister, together with the following papers (D.R.E. Art. 12): —

(1) Minutes of the resolutions of the shareholders' general meeting and papers sufficient to evidence the consent of partners (in case of companies other than joint stock companies).
(2) The contract relative to the amalgamation.
(3) Articles of Association of the bank surviving or being created.
(4) Inventory and balance sheet made within two weeks after the date of resolution on amalgamation, in accordance with Article 78 of the Commercial Code.
(5) Papers enough to show that the advertisement and notification in accordance with the aforesaid paragraph 2 Article 78 of the Commercial Code and the notification relative to the assignment of shares with the purpose of their consolidation in accordance with the aforesaid Article 220½ of the Commercial Code, have duly been given out.

In case the amalgamated bank acquires the rights and obligations pertaining to a savings bank in accordance with the terms of Article 1 of the Savings Bank Act, the bank resulting from such amalgamation may carry on such savings bank business until contracts made by the savings bank so absorbed are performed. (B.A. Art. 17).

The purchasing bank must file a notification with the Finance Minister (D.R.E. Art. 17). For the establishment of branches and other business places as a result of such purchase the Minister's permits are required (B.A. Art. 6). The purchased bank has to obtain a sanction from the Minister on its dissolution (B.A. Art. 25).

Abolition of Business or Dissolution. Resolutions for the abolition of a banking business or the dissolution of a bank are not valid until the sanction of the Minister in charge is given (B.A. Art. 25).

After the resolution a written application must be filed with the Finance Minister, together with the following papers (D.R.E. Art. 15): —

(1) Statement of reasons.
(2) Minutes of the resolutions at the shareholders' general meeting.
(3) The latest daily statement.
(4) Statement as to assets and liabilities.
(5) Statement on the method of payment of deposits.

In case a bank has changed into another type of business corporation and abandons the banking business, the Minister in charge of banking affairs is authorized to order the deposit of properties of such corporation, or issue any other necessary orders, until their liabilities resulting from deposits are cancelled. (B.A. Art. 26).

The same rule applies in the case of any business corporation taking over by amalgamation the deposits of a bank (B.A. Art. 26) and the Minister concerned has jurisdiction over such corporation as though it were a bank.

So far as a bank is a joint stock company, its dissolution may take place by virtue of one of the following reasons (C.C. Art. 221): —

(1) Expiration of the life of the company or any other causes prescribed by the articles of association.
(2) Achievement or failure of the business, which has been the purpose of incorporation.
(3) Amalgamation of corporations.
(4) Bankruptcy.
(5) Order of the Court of Justice.
(6) Resolution of shareholders' general meeting.
(7) When the number of shareholders is reduced to less than seven.

The Bank Act provides that another cause of dissolution, peculiar to banks, is the repeal of their license (B.A. Art. 27).

LIQUIDATION. In the case of the dissolution of a bank caused by the repeal of its license, the Court of Justice appoints either on its own authority, or by the request of parties concerned, the liquidator (B.A. Art. 27). The same rule applies to dissolutions caused by any other reason. Moreover, in case of his release, the

court is authorized to appoint another on its own authority (B.A. Art. 28). The Court is authorized in general to investigate the progress of liquidation and the condition of the properties, to order the deposit of properties and issue any other order necessary to the supervision of the liquidation (B.A. Art. 29).

In case of liquidation, bankruptcy or compulsory settlement of a bank's affairs, the Court is authorized to call for the opinion of the Government officials engaged in the examination and supervision of banks, or to entrust them with examination or investigation. Moreover, these officials are empowered to express their opinions to the court, even though not expressly requested to do so (B.A. Art. 30, 31).

Supervision of Banks. The Minister concerned is authorized, whenever he considers it necessary, to require a bank to file with him reports on its business or certificates of inspection and any other papers and books (B.A. Art. 20). He is also empowered to order, whenever he considers it necessary, his subordinate officials to examine the business conditions and properties of a bank (B.A. Art. 21).

For this purpose, on May 25, 1927, the Government created in the Bureau of Banking of the Finance Department a staff composed of eighteen bank examiners with fifty-four assistant examiners and a number of clerks. This new bank examination system, together with the examination conducted by the Bank of Japan under contract with its correspondent banks, is expected to contribute much to the healthy development of the financial organization of Japan.

Reporting Obligations. As already described there are many obligations imposed upon a bank by the banking laws and regulations; such as, filing of business reports (B.A. Art. 10), notifications of extraordinary bank closures (B.A. Art. 18), of general suspension of payment of deposits (B.A. Art. 19), of commencement of business (D.R.E. Art. 3), of abolition of business places (D.R.E. Art. 16), etc. Besides these, a bank is required to report without delay to the Minister the following facts with their reasons (D.R.E. Art. 17): —

(1) Alteration in Articles of Association.
(2) When there is a change in title, capital or place of business,

or the amalgamation of banks has taken place with the Finance Minister's sanction (cf. B.A. Art. 6, 14).

(3) When the assumption of, or retirement from office of a representative director or directors or managers engaged in the daily business has taken place.

(4) When those officers participating in the daily business of another corporation have ceased to do so (cf. B.A. Art. 13).

(5) When the alteration, termination or renewal of an agency contract has taken place.

(6) When any bank in suspension of payment of deposits has resumed such payment (B.A. Art. 18, D.R.E. Art. 14).

(7) When composition with creditors has been started, the approval of the creditors when the composition has become final and conclusive, or when the composition has become void.

(8) When an adjudication of bankruptcy has been given, or protested; or a decision of court has been given to the protest (Bankruptcy Act. 112, 113).

(9) When a decision on the approval of compulsory composition of creditors has become final and conclusive, or the composition has become void.

(10) When a bank has taken over another's business without resorting to the method of bank amalgamation.

When a bank, having closed its business due to catastrophes or other unavoidable reasons, has been reopened, the fact must be reported without delay to a local governor (D.R.E. Art. 17).

Though as a general rule all the papers to and from the Minister are to go through local governors, there are some exceptions. Any papers of business secrecy, such as auditing papers and other books demanded by the Minister concerned in accordance with Article 20 of the Bank Act, and examination papers required by Article 21, must be submitted directly to the Finance Minister (D.R.E. 29).

Legal Sanction. The minister concerned is authorized, whenever he considers it necessary in consideration of business conditions and the properties of a bank, to suspend its business, to demand deposits of its properties, or to issue any other necessary orders (B.A. Art. 22).

In case a bank acts contrary to the laws, regulations, articles of association, the Minister's orders or the public welfare, the Minister concerned is authorized to suspend its business, demand the change of directors and auditors or the forfeiture of its license (B.A. Art. 23). He is also empowered, whenever he considers it necessary in the course of the liquidation of a bank, to take away the license of a bank when it has suspended business by order of the Ministry of Finance (B.A. Art. 24).

Penalties. As a general rule there is a monetary fine imposed for the violation of any banking laws, though in a few instances penal punishment is inflicted. Such penalties are imposed on the offending individuals of a bank, but not on a bank as a body corporate.

To carry on a banking business without the Minister's license is punishable by a fine of not exceeding 5000 yen (B.A. Art. 33).

Using any word indicative of a bank by any institution other than a bank is punishable by a fine of not less than 10 yen, nor more than 100 yen (B.A. Art. 36).

Directors, auditors, managers, liquidators or representatives of banking institutions with head offices outside the territory wherein the Bank Act is enforced, in other words, foreign banks and quasi-foreign banks, are subject to a penalty of not more than one year's imprisonment or servitude, or of a fine not exceeding 1000 yen, in the following cases (B.A. Art. 34): —

(1) Having deceived the government or the public by untrue statements in business reports, or auditing papers, false advertisements or by some other means.
(2) Having obstructed the examination prescribed in the Bank Act by concealing books and papers, false statements or by some other means.

The aforesaid bank officers (excluding the liquidators) are under penalty of a fine of less than 100 yen (D.R.E. Art. 30), in case of: —

(1) Negligence in notification, or submitting papers demanded by the Detailed Regulations for Enforcement.
(2) False statements in the above notification, or in papers, or the concealment of facts.

The aforesaid bank officers, agents and liquidators are under penalty of a fine over 10 yen, but not exceeding 1000 yen in the following cases (B.S. Art. 35): —

(1) Violations of provisions of Articles 5, 6, 7, 8 or 13 of the Bank Act (that is, as already described, carrying on prohibited business; change in the title, capital or business places without the Minister's sanction; opening of sub-agencies, etc.; failure to set aside legal reserves; engagement in another occupation without the Minister's sanction).
(2) Violations of provisions of Article 9 of the Savings Bank Act, applied correspondingly to ordinary banks by Article 17 of the Bank Act (that is, failure of the deposits necessitated as a result of taking over by an ordinary bank of rights and obligations of a savings bank amalgamated by the former).
(3) Failure to prepare the papers at a bank or negligence in filing them with the Minister concerned, as required by the Bank Act; or failure to fill in the required items in the papers or false statement thereon.
(4) Negligence or false statements in the notification or advertisement prescribed in the Bank Act.
(5) Having acted contrary to orders issued by the Minister concerned or by the Court of Justice in accordance with Articles 22, 23, 26 or 29 of the Bank Act, (that is, orders of business suspension, deposit of properties, etc., issued by the Minister in consideration of business or property condition of a bank; orders of business suspension or change of officers issued by the Minister, in case a bank has acted against the laws, regulations, the Minister's orders or public welfare; orders of deposit of properties, etc., issued by the Minister concerned; when a bank has changed into other kind of business corporation or any business corporation has taken over the deposits' liabilities of a bank, or orders issued by court of justice on deposit of property, etc., necessitated by liquidation).
(6) Having acted contrary to the orders issued in accordance with the provisions of the Bank Act.

FOREIGN BANKS AND QUASI-FOREIGN BANKS

Definition. The zone wherein the new Bank Act is enforced is extended from Japan proper to Taiwan (Formosa) and Karafuto (Japanese Saghalien) by the Imperial Ordinances No. 340 and No. 341 of 1927. Any Japanese bank with its head office outside the above zone, in other words in Korea, Kwantung Province (leased territory) or China (due to the extra-territoriality) are treated in the Act almost on a par with foreign banks, that is, banking institutions established in accordance with foreign laws.

Establishment of Business Places. When a foreign or quasi-foreign bank intends to carry on the banking business with branches, stations or agencies within the zone wherein the Bank Act is enforced, a written application from the head office, signed by a representative of the corporation, must be filed with the Finance Minister for every business place, with a representative appointed thereto (B.A. Art. 32). It must be accompanied by the following papers: —

(1) Papers sufficient to recognize the existence of its head office; such as, copies of registry, license, etc.; with the certification of the foreign authority having jurisdiction over such corporation, or of the foreign consul functioning in Japan.
(2) Papers sufficient to certify the qualification of a representative of the corporation; such as, certificate by a notary public of the country of the foreign corporation, with the certification of the foreign authority having jurisdiction over such corporation, or of the foreign consul functioning in Japan.
(3) The contract of agency, in case of establishing an agency.
(4) Articles of Association or any other papers sufficient to show the nature of such corporation.
(5) A copy of the license, in case such is required for the opening of such business place by the foreign authority having jurisdiction over such corporation.
(6) The latest inventory, balance sheet, profit and loss ac-

count, disposal of profit or any other papers sufficient to show the business conditions of the corporation.

(7) List of principal capital subscribers and officers of the corporation, with their nationalities and domiciles.

The above procedure applies correspondingly to any banking institution, not incorporated, intending to establish branches, stations or agencies within the zone wherein the Bank Act is enforced (D.R.E. Art. 18).

The Minister concerned is authorized to put specific restrictions on issuing a license (B.A. Art. 32). This provision has the purpose of giving to the applying foreign corporation treatment equal to that which a Japanese corporation enjoys in the country of the foreign bank (I.O. Art. 1).

Deposits. Having been licensed, such a business place is deemed a bank in the application of the Bank Act; though of course special provisions are left to the ordinances, as the Act as it is cannot be applied to such foreign business institutions. For instance, the provisions in the Article 3 of the Bank Act relative to the organization and capital of a bank is not applied to a foreign bank (I.O. Art. 1).

For any business place to be established, national loan bonds or other securities, sanctioned by the Finance Minister, equivalent to 100,000 yen must be deposited (I.O. Art. 2). National Loan Bonds means those of the Japanese Government, including those in registered form. In order to obtain the Finance Minister's sanction on the securities to be deposited, a written application must be filed with him, accompanied by papers sufficient to show — (A) The issuer and his domicile, (B) The rate of interest, secured or non-secured and kind of security, in case of debentures or public loan bonds other than national loan bonds, (C) The latest stock exchange quotations or any other price list (D.R.E. Art. 19).

The deposit must be made at every place where a business office is located (D.R.E. Art. 20). Having thus been deposited, the fact must without delay be sent to the Finance Minister, together with the receipt for the deposit (D.R.E. Art. 22).

In case the current prices of the deposited securities go below 100,000 yen at the end of a business year, the balance must be

made up by depositing other prescribed bonds or securities (D.R.E. Art. 21). The Finance Minister must without delay be notified of this.

The return of bonds or securities thus deposited for various reasons requires the Finance Minister's sanction, which is given for a written application with the statement of reasons, kinds of bonds or securities, their marks and numerals, their number, face value, amount paid up and their current prices (D.R.E. Art. 23).

There is five years' grace for deposits to be made by those foreign banks having on January 1, 1928, the date on which the aforesaid Imperial Ordinance took effect, any business place and carrying on the banking business within the zone wherein the Bank Act is enforced.

Title. A foreign bank is not required to use in its trade name any word indicating a "bank." (I.O. Art. 1). Its business place, even if actually a station, need not be called a station. (D.R.E. Art. 24).

Subsidiary Business. A foreign bank may also carry on at its business place any business subsidiary to banking. It is not qualified, however, to engage in the trust business provided in the Secured Debentures Trust Act. To any foreign bank carrying on at its business place on the date of enforcement of the Act (that is, on January 1, 1928) any other business than the subsidiary business recognized by the Bank Act, a five years' grace is given. (I.O. Supplementary Rule).

Other Occupations. The representative or manager of the business place of a foreign bank, intending to participate in the daily business of any other corporation, has to apply for the Finance Minister's sanction thereto (I.O. Art. 6), though one year's grace is given to those actually participating in such business on January 1, 1928. To the above application, the procedure prescribed for a domestic bank applies accordingly (D.R.E. Art. 27).

Legal Reserve and Auditing Paper. These are not required for a foreign bank, as it is not required to be a joint stock company; nor to a quasi-foreign bank, as these provisions are not applicable to banks organized under the laws of other jurisdictions.

Application for the Minister's Sanctions. The representative of a foreign bank, or a quasi-foreign bank, must apply for

the Minister's sanction in case he intends, (A) to change the location of its business place, (B) to change the type of business transacted at an office; or (C) to give up the banking business at its place of business.

NOTIFICATION TO THE MINISTER. The following facts must without delay be notified the Finance Minister by the representative of a foreign bank or a quasi-foreign bank: —
(A) Change of the title of the bank. (B) Change in its capital. (C) Change of the location of its head office. (D) Abolition of the banking business at its head office and (E) dissolution or amalgamation (I.O. Art. 11). In case these banks have prepared at a certain settling time the business report, balance sheet, profit and loss account, disposal of profits and any other papers on all kinds of business carried on by them, copies of these must without delay be filed with the Finance Minister (D.R.E. Art. 25).

DISSOLUTION, LIQUIDATION OR BANKRUPTCY. The provisions regulating a Japanese bank in these matters do not apply to a foreign bank (I.O. Art. 1).

In case the banking business of one business place is abolished, or the license therefor is forfeited, the Finance Minister is authorized to order the other business place of the same corporation to take over the former's banking business (I.O. Art. 7).

In the following cases, a foreign bank may be deemed as dissolved and may be ordered to go into liquidation (I.O. Art. 8): —

(A) When the banking business at its head office has been abolished.
(B) When the banking business at a certain business place, the only one existing in Japan, has been abolished; or the license therefor has been foreited.

In case of the forfeiture of license, the Court of Justice is authorized to appoint liquidators by the request of the parties concerned or on its own authority (I.O. Art. 9).

In case dissolution of the bank has taken place in accordance with the laws of the country, or in case it has been deemed dissolved in accordance with the aforesaid Article 8 of the Imperial Ordinance, the representative of such business place becomes a liquidator, though the court is authorized, either by the

request of the parties concerned or on its own authority, to relieve the liquidators. In case there was no such representative, or the liquidator has ceased to exist, the court is authorized to appoint or relieve the liquidators either by the request of parties concerned or on its own authority. In both cases of the release of liquidators, the court is authorized to appoint new liquidators. (I.O. Art. 10).

SAVINGS BANKS

Definition. According to paragraph one of the Article 1 of the Savings Bank Act, a savings bank is an institution carrying on the following business: —

(1) The receipt of deposits at compound interest.
(2) The receipt of single deposits of less than 10 yen each.
(3) The receipt of deposits periodically or occasionally during certain periods with fixed date for their repayment.
(4) The receipt of money periodically or occasionally during a certain period under promise to pay certain sums of money at a certain date.

The difference between a savings bank and an ordinary bank lies, therefore, in the following; the latter has to carry on the business of both giving and receiving credits, while the former is not necessarily required to engage in the business of granting credit. It will suffice to invest its funds, for instance, in securities.

The Savings Bank is also authorized to engage in such subsidiary businesses as: —

(1) The receipt of fixed deposits.
(2) A safe deposit business.
(3) The collection of debts.
(4) The receipt or payment of money as treasurers for public corporations or coöperative societies.
(5) The receipt of demand deposits from public corporations or coöperative societies.

Organization. A savings bank must be a joint stock company with the minimum capital of 500,000 yen. It must obtain

a license from the Finance Minister in order to carry on its business. Though there are several savings banks in Japan bearing the name of "mutual" and operating as far as possible on mutual basis, yet legally they are still joint stock companies.

Investment. A savings bank is not permitted to invest its funds in any other way than the following: —

(1) To subscribe for, underwrite, or purchase national or local bonds, debentures and stock of private corporations with the approval of the Finance Minister.
(2) To make loans on the above securities.
(3) To make real estate mortgage loans.
(4) To make loans to its depositors to the extent of their individual deposits.
(5) To make loans to those persons depositing money periodically or occasionally during a certain period under promise to pay certain sums of money on a certain date, to the extent of their individual deposits.
(6) To deposit money in other banks or postal savings bank.
(7) To purchase bills accepted by banks.

There are further restrictions imposed on their business as follows: —

(1) The amount of shares of a certain company to be owned by a savings bank, or to be received by it as guaranty for its loans or deposits, shall not exceed one-fifth of the total shares of such company.
(2) Loans to a single person shall not exceed one-tenth of the total amount of paid-up capital and reserve funds of the bank.
(3) The total amount of real estate mortgage loans shall not exceed the total amount of paid-up capital and reserve funds of the bank.
(4) The total amount of deposits in certain other banks and of bills purchased with the acceptance by said bank shall not exceed one-tenth of the total deposits received by a savings bank, or one-fourth of the paid-up capital and reserve funds of the former.

Liability. Savings Banks are required to deposit government bonds with the Deposit Bureau as guarantee for repayment of their deposits. The amount of such bonds to be deposited must be not less than one-third of the total amount of deposits.

When a savings bank fails to pay its liabilities with its assets, its directors are under joint unlimited liability so far as the deposits received before their resignations are concerned. This liability lasts for two years after the resignation.

SPECIAL BANKS

Banks of Issue: The Bank of Japan. The Bank of Japan (Nippon Ginko), the central bank of the country, is a joint stock company established in accordance with the Bank of Japan Act, with an authorized capital of 60,000,000 yen, of which 37,500,000 yen has been paid up. Its shares are not held by banks, as in the case of the Federal Reserve Banks in America, but by individuals or Japanese corporations.

The directorate of the Bank is composed of one Governor, one Deputy Governor, four Directors and five Auditors, all of whom are appointed by the Government.

Besides its head office in Tokyo, it has branches in the leading business centers of the country and many agencies both at home and abroad.

The principal business of the Bank is as follows: —

(1) To discount or purchase Government bills, bills of exchange and commercial papers.
(2) To buy or sell gold and silver bullion.
(3) To make loans on the security of gold and silver coins and bullion.
(4) To collect bills for banks, companies and merchants having business connections with the Bank.
(5) To receive deposits of money and gold, silver and other precious metals and documents for safe keeping.
(6) To make advances on current accounts, or to make loans redeemable on a fixed date on the security of Government bonds, notes, and other securities with the Government guarantee.

The Bank is, in addition, authorized to handle the receipts and disbursements of the Treasury.

According to the Convertible Notes Act, the Bank of Japan, in addition to the notes issued against gold and silver coin and bullion in reserve, is authorized to issue notes to an extent not exceeding 120,000,000 yen on the security of Government bonds, Treasury certificates of indebtedness and other prime securities and commercial papers. Should it be deemed necessary to issue bank notes beyond this limit, the Bank is authorized to do so with the Finance Minister's sanction; though an issuing tax at the minimum rate of five per cent. per annum is levied on the amount so issued.

The Bank of Taiwan. The Bank of Taiwan (Taiwan Ginko), organized in accordance with the Bank of Taiwan Act, is a joint stock company with an authorized capital of 45,000,000 yen, of which 39,375,000 yen has been paid up. It has a directorate of more or less similar composition to that of the Bank of Japan.

Its head office is in Taipeh, Formosa, and its three branches scattered chiefly in its principal sphere of activities, that is, Formosa, Southern China, Java and India. As in the case of other special banks with their head office outside of the capital, its Tokyo office, though merely a branch in name, is actually its business center on account of the city's vast importance as the nation's financial center.

The principal business of the Bank is as follows: —

(1) To discount bills of exchange and other commercial papers.
(2) To deal in bills of exchange and documentary bills.
(3) To collect bills for companies and merchants having business connection with the bank.
(4) To make loans on securities of a reliable nature.
(5) To receive deposits of money and to make advances on current accounts.
(6) To receive valuables, such as gold, silver and other precious metals and documents for safe deposit.
(7) To buy or sell gold and silver bullion or foreign coins.
(8) To act as agents for other banks.
(9) To engage in the secured debentures trust business.

(10) To make unsecured loans to communities, coöperative societies or stock breeding associations.
(11) To subscribe for, to underwrite the issue of, or to purchase national or local loan bonds, Hypothec Bank of Japan Debentures, Agricultural and Industrial Bank Debentures, Industrial Bank of Japan Debentures, and other securities approved by the Minister concerned.
(12) To take charge of the instalment payment of the subscribers for the national or local loan bonds, bonds and shares of corporations; or of the payment of their principal, interest and dividends.

The Bank has the privilege of issuing its bank notes in denominations of one yen and upward and convertible into the gold yen. In addition to the notes issued against gold and silver coins and bullions in reserve, the Bank is authorized to issue the notes up to 20,000,000 yen on the security of Government bonds and Treasury certificates of indebtedness, Bank of Japan notes and other prime securities and commercial papers. Notes issued beyond this limit are subject to a minimum tax of five per cent. per annum.

The Bank of Chosen. The Bank of Chosen (Chosen Ginko), organized in accordance with the Bank of Chosen Act, is a joint stock company with an authorized capital of 80,000,000 yen, of which 50,000,000 yen has been paid up. The directorate of this bank also has a more or less similar composition to that of the Bank of Japan.

Besides its head office in Keijo (Seoul), Korea, it has twenty-nine branches chiefly scattered in its principal sphere of activities, that is, Korean Peninsula, Manchuria, Northern China and Siberia.

The principal business of the bank is: —

(1) To discount bills of exchange and other commercial papers.
(2) To deal in bills of exchange and documentary bills.
(3) To collect bills for the companies and merchants having business connections with the Bank.
(4) To make loans on securities of reliable nature.
(5) To receive deposits of money and to make advances on current account.

(6) To receive valuables such as gold, silver and other precious metals and documents for safe deposit.
(7) To buy or sell gold and silver bullion or foreign coins.
(8) To engage in the secured debentures trust business.
(9) To purchase national or local loan bonds and other prime negotiable papers designated by the Governor General of Chosen.
(10) To make unsecured loans to public corporations, or to act as agents for other banks with the approval of the Governor General of Chosen.

The Bank has the privilege of issuing notes against gold coins, gold and silver bullion and Bank of Japan notes in reserve. In addition to this, the Bank is authorized to issue the notes up to 50,000,000 yen on the security of Government bonds, other bonds and prime commercial bills. In case of necessity, the Bank is further authorized to issue the notes beyond this limit, though subject to a minimum tax of five per cent. per annum.

BANK-NOTE CIRCULATION

(000 omitted, in yen)

Outstanding at the end of		Bank of Japan	Bank of Chosen	Bank of Taiwan
1914		380,565	21,850	14,247
1915		420,775	34,387	17,611
1920		1,400,448	114,034	40,249
1925		1,599,206	120,541	53,186
1926		1,541,645	110,937	48,640
1927	Jan.	1,394,321	106,606	49,195
	Feb.	1,237,980	101,479	43,324
	Mar.	1,326,313	100,618	42,412
	Apr.*	2,008,764	114,271	51,441
	May	1,406,322	90,776	44,335
	June	1,443,182	88,977	43,546
	July	1,316,829	80,809	44,531
	Aug.	1,272,237	77,116	44,169
	Sept.	1,254,200	78,776	43,403
	Oct.	1,312,001	89,886	44,988
	Nov.	1,292,918	109,803	45,108
	Dec.	1,640,663	124,527	53,602

* The month of the unprecedented financial panic.

Banks for the Financing of Agriculture and Industry: The Industrial Bank of Japan. The Industrial Bank of Japan (Nippon Kogyo Ginko) is a joint stock company organized in accordance with the Industrial Bank of Japan Act, with an authorized capital of 50,000,000 yen, fully paid up.

The directorate of this bank is chosen similarly to that of the Bank of Japan.

Besides its head office in Tokyo, it has several branches in Japan proper.

The principal business of the Bank is as follows: —

(1) To make loans on pledge of national and local loan bonds and corporation bonds and shares.
(2) To subscribe for, or to underwrite the issue of, national and local loan bonds and corporation bonds.
(3) To receive deposits of money and accept valuables for safe deposit.
(4) To engage in the secured debentures trust business.
(5) To discount bills.
(6) To deal in bills of exchange.
(7) To make first mortgage loans on trustee property created in accordance with the provisions of laws.
(8) To make first mortgage loans on ships, or ships under construction, redeemable in annual instalments within a period not exceeding fifteen years, or on a certain date within five years from the date of loan.
(9) To make loans on shipbuilding materials or ship equipments.
(10) To subscribe for, or to underwrite the issue of the shares with the approval of the Minister concerned.
(11) To subscribe for, or to underwrite the issue of national and local loan bonds and corporation debentures; to handle the instalment payments of their subscribers, or the payment of their principal and interest and also for the payment of dividends on shares.
(12) To make first mortgage temporary loans or those of fixed date on lots and buildings, either factories or residences, located in the zone wherein the City Planning Act is enforced, or in other cities to be designated by an Imperial

Ordinance. The total amount of these loans, however, shall not exceed one-half of the amount of paid up capital of the Bank.

(13) To purchase national or local loan bonds, corporation shares and debentures, or gold and silver bullion.

(14) And other business sanctioned by the Minister concerned in accordance with the laws or regulations.

The Bank is authorized to issue debentures of a minimum denomination of twenty yen (or its equivalent in foreign currency) to the extent not exceeding ten times its paid-up capital. The amount of such debentures, however, is not allowed to exceed the total amount of outstanding loans, bills discounted and national or local, loan bonds, corporation bonds and shares, and gold and silver bullion in hand. In case funds are required for enterprises of public welfare undertaken in a foreign country and designated by the Minister concerned, the Bank is authorized to issue, with the approval of the Minister concerned, debentures beyond the above limit.

The Hypothec Bank of Japan. The Hypothec Bank of Japan (Nippon Kwangyo Ginko) is a joint stock company organized in accordance with the Hypothec Bank of Japan Act, with an authorized capital of 99,000,000 yen, of which 74,876,062.5 yen (December 31, 1927) is paid up. The capital of the bank is now steadily increasing due to its merger with the local Agricultural and Industrial Banks. The composition of its directorate is more or less similar to that of the Bank of Japan. Besides its head office in Tokyo, there are many branches throughout the country, the number of which has greatly increased in recent years on account of its amalgamation of the aforesaid local institutions.

The following is the principal business of the Bank: —

(1) To make real estate mortgage loans, redeemable in annual instalments within a period not exceeding fifteen years or on a certain date within five years; the total of the latter shall not exceed the total amount of the paid-up capital and reserve of the bank. The amount of loans on residential lots and buildings located in a zone wherein the City

Planning Act is enforced, or in other cities to be designated by an Imperial Ordinance, shall not exceed one-half of the total of the paid-up capital and the mortgage debentures outstanding.

(2) To make unsecured loans to prefectures, cities, towns, villages and other public corporations.

(3) To make unsecured loans redeemable on a certain date or in annual instalments for the adjustment of arable lands conducted in accordance with the Adjustment of Arable Lands Act.

(4) To make unsecured loans redeemable on certain date or in annual instalments to coöperative societies, staple export goods manufacturing, fishery, forestry, stock-breeding or building associations; or their combinations.

(5) To make unsecured loans, redeemable on a certain date within five years, to a party of more than ten persons under joint liability and engaged in agriculture, industry or fishery in any prefecture where no Agricultural and Industrial Bank exists.

(6) The proceeds of the Hypothec Bank Debentures issued at a premium are limited to be employed in the following ways: —

(A) To make loans on arable lands, salt fields, forests, pastures, fish farms or fishery rights.

(B) To make unsecured loans to those mentioned in the above (2), (3), (4) and (5).

(C) To underwrite the issue of debentures by local Agricultural and Industrial Banks or those of the Central Chest for Coöperative Societies.

(7) To underwrite the issue of debentures of Agricultural and Industrial Banks, the Central Chest for Coöperative Societies, the Hokkaido Colonial Bank and the Industrial Bank of Chosen.

(8) To make secured loans redeemable in annual instalments on the claim on loans given by Agricultural and Industrial Banks and redeemable by annual instalments; and on mortgage held against such loans.

(9) To receive deposits of money and accept valuables for safe deposit. The total amount of other deposits than the

fixed deposits and deposits by prefectures and cities shall not exceed the total amount of the paid-up capital.

(10) Its deposits of money and idle funds are limited to be employed in the following ways: —

(a) To purchase to the extent of not less than one-fourth of the deposits, national loan bonds or other negotiable papers approved by the Finance Minister; or to deposit it in the banks approved by the Finance Minister.

(b) To discount bills or to make short term loans secured by the above mentioned negotiable papers, or agricultural, marine or industrial products.

(c) To discount bills or to make advances on current accounts of coöperative societies, staple export goods manufacturing associations, fishery associations or of their combinations.

(d) To make short term loans to communities.

(e) To make short term unsecured loans to a party of more than ten persons under joint liability and engaged in agriculture, industry or fishery in any prefecture where no local Agricultural and Industrial Bank exists.

(f) To make with fixed deposits secured loans, redeemable on a certain date within five years on real estate or fishery right.

The Bank is authorized, when at least one-fourth of its authorized capital has been paid up, to issue mortgage debentures to an amount not exceeding fifteen times its paid-up capital. The total amount of such debentures shall not exceed the total of the loans outstanding, redeemable in annual instalments on a certain date, and the debentures of the Agricultural and Industrial Banks, Hokkaido Colonial Bank and the Industrial Bank of Chosen in hand. These mortgage debentures are to be redeemed by means of drawings taking place at least twice a year proportionate to the amount of the same year's redemption of the loans and debentures mentioned above. Should any loans redeemable by annual instalments be redeemed before their maturity, the

Bank is authorized to purchase and redeem its mortgage debentures to the extent so repaid.

Agricultural and Industrial Banks. Agricultural and Industrial Banks (Noko Ginko) are local financial institutions furnishing long-term real estate loans at low interest. As has already been explained in the foregoing chapters a way is open for their merger with the Hypothec Bank of Japan, their central body.

They are joint stock companies, organized in accordance with the Agricultural and Industrial Banks Act, with an authorized capital of not less than 500,000 yen each. As a general rule each bank has one prefecture as its exclusive business district.

The principal business of the Agricultural and Industrial Banks is as follows: —

1. To make real estate mortgage loans redeemable in annual instalments within a period not exceeding fifty years; or to make secured loans on either real estate or fishery rights redeemable on a certain date within five years. In the latter case, however, their total shall not exceed the total amount of the paid-up capital and reserves. The amount of secured loans on residential lots and buildings located in the zone wherein the City Planning Act is in force, or in cities designated by an Imperial Ordinance shall not exceed one-fourth of the total amount of paid-up capital and mortgage debentures outstanding, though such loans in the localities to be specified by an Imperial Ordinance may be increased to three-fourths of the total amount of the paid-up capital and mortgage debentures outstanding.
2. To make unsecured loans to cities, towns, villages and other public corporations.
3. To make unsecured loans, redeemable on a certain date within five years, to a party of more than ten persons under joint liability and engaged in agriculture, industry or fishery.
4. To make unsecured loans, redeemable in annual instalments within a fifty year period or on a certain date within five years, to arable lands adjustment associations or their

combinations, provided such adjustment is to be done in accordance with the Arable Lands Adjustment Act.

5. To make unsecured loans, redeemable in annual instalments within a period of not exceeding fifty years or to make mortgage loans on a certain date within five years, to coöperative societies; staple export goods manufacturing, fishery, forestry, stock-breeding or building associations, or to their combinations.
6. The proceeds of the issue of Agricultural and Industrial Bank debentures underwritten by the Hypothec Bank of Japan with the proceeds of the latter's debentures issued at a premium are limited to be employed in the following manner: —
   (a) To make loans on arable lands, salt fields, forests, pastures, fish farms or fishery rights.
   (b) To make unsecured loans to those mentioned in the above (2), (3), (4) and (5).
7. To receive deposits of money and accept gold and silver bullion, and negotiable papers for safe deposit; the total amount of other deposits than fixed deposits and deposits by prefectures and cities, however, shall not exceed the paid-up capital.
8. Deposits of money and idle funds are limited to be employed in the following manners: —
   (a) To purchase to the extent of not less than one-fourth of the deposits, national loan bonds or other negotiable papers approved by the Finance Minister; or to deposit it in the Deposit Section of the Finance Department or in the banks approved by the Finance Minister.
   (b) To discount bills, or to make short term loans secured by the above mentioned negotiable papers, or agricultural, marine or industrial products.
   (c) To discount bills, or to make advances on current accounts of coöperative societies, staple goods export manufacturing or fishery associations, or of their combinations.
   (d) To make short-term unsecured loans to a party of ten

persons under joint liability and engaged in agriculture, industry or fishery.

(e) To make short-term loans to communities.

Agricultural and Industrial Banks are allowed to become agents for the Hypothec Bank of Japan; and when acting as agents for loans made by the Bank they are authorized to guarantee for the Bank the solvency of the borrowers. They are also authorized to take charge of the receipts and disbursements of the funds of prefectures and cities.

The banks are permitted, when at least one-fourth of their authorized capital has been paid up, to issue mortgage debentures to an extent not exceeding ten times their paid-up capital. The total amount of such debentures shall not exceed the aggregate of (a) the difference between the total outstanding loans redeemable in annual instalments and the portion set aside as security for the money borrowed from the Hypothec Bank of Japan and (b) the total outstanding loans redeemable on a certain date within a certain period.

The face value of the debentures is ten yen and upwards. They are to be redeemed by means of drawing, taking place at least twice a year, to the extent proportionate to the amount of the same year's redemption of loans redeemable in annual instalments, deducting, however, therefrom the portion set aside, as mentioned above, as security to the Hypothec Bank.

Industrial Bank of Chosen. The Industrial Bank of Chosen (Chosen Shokysan Ginko), organized in accordance with the Industrial Bank of Chosen Act of June 1918, is a joint stock company with an authorized capital of 30,000,000 yen. Its head office is situated in Keijo (Seoul), the capital of Korea, with fifty-two branches throughout the Peninsula.

According to the Act, the principal authorized business of the Bank is as follows: —

1. To make mortgage loans, redeemable on a certain date within five years on fishery rights.
2. To make loans, redeemable on a certain date within five years, to farmers or manufacturers under joint liability.
3. To make loans, redeemable by instalments within a period

of less than fifty years or on a certain date less than five years, to public corporations or other corporations specified by the Government.

4. To make advances on products of Chosen or on goods essential for the industrial development of Chosen.
5. To make advances on national loan bonds or on such securities as approved by the Governor General of Chosen.
6. To deal in bills or documentary bills.
7. To engage in trust business; to receive deposits of money or to receive gold and silver bullion or negotiable papers for safe deposit; to act, with the Governor General's sanction, as agent for other banks or companies, or as cashier for public corporations; to engage, with the Governor General's sanction, in ordinary banking business.

The Bank has the privilege of issuing its debentures to the amount of fifteen times its paid-up capital.

The Hokkaido Colonial Bank. The Hokkaido Colonial Bank (Hokkaido Takushoku Ginko), organized in accordance with the Hokkaido Colonial Bank Act, is a joint stock company with an authorized capital of 20,000,000 yen, of which 12,500,000 yen has been paid up. Its head office is situated in Sapporo, the capital of the Island of Hokkaido in northern Japan. It has several branches throughout the island and one in Tokyo.

The principal business of the Bank is as follows: —

1. To make real estate mortgage loans redeemable in annual instalments within a period not exceeding fifty years, or to make mortgage loans on real estate or fishery rights, redeemable on a certain date within five years.
2. To make secured loans on bonds and shares of joint stock companies organized for the purpose of colonization and exploitation of Hokkaido and Karafuto; and to subscribe for or underwrite the bond issue of such companies.
3. To deal in bills of exchange and documentary bills, and to make secured loans on agricultural and marine products of Hokkaido and Karafuto.
4. To receive deposits of money and accept valuables for safe deposit.
5. To discount bills.

6. To engage in secured debentures trust business.
7. To act as agents for other banks.
8. To underwrite the issue of national and local loan bonds, and corporation debentures; or to handle instalment payments of their subscribers; or to act as agents of their issuers for their principal interest and dividend agents.
9. To make secured loans on goods and merchandise necessary for industry and stored in the warehouse established chiefly for storing agricultural and marine products of Hokkaido and Karafuto.
10. To make unsecured loans, redeemable in annual instalments or on a certain date to public corporations in Hokkaido.
11. To make unsecured loans, redeemable on a certain date within five years, to a party of more than ten persons under joint liability and engaged in agriculture, industry or fishery.
12. To make unsecured loans, redeemable in annual instalments or on a certain date within a certain period, to coöperative societies, staple export goods manufacturing, fishery, forestry, stock-breeding or building associations or their combinations.
13. To make unsecured loans, redeemable in annual instalments or on a certain date within certain period, to arable lands adjustment associations or their combinations, provided such adjustment is to be made in accordance with the Arable Lands Adjustment Act.
14. To make short term secured loans on national loan bonds or negotiable papers approved by the Minister concerned.
15. To subscribe for, underwrite or to purchase national or local loan bonds, corporation debentures or negotiable papers approved by the Minister concerned with idle funds.

The total amount of the loans mentioned in (2), (3), (5), (9) and (14) shall not exceed the total of the loans mentioned in (1), (10), (11), (12) and (13). The Bank is further authorized with the Finance Minister's approval, to carry on (in Karafuto) banking business other than that mentioned above.

The Bank is also authorized to issue debentures of the face

value of not less than ten yen to the extent not exceeding ten times its paid-up capital. The total of such debentures, however, must not exceed the total of the outstanding loans, redeemable in annual instalments or on a certain date within certain period. These debentures are to be redeemed by means of drawings taking place at least twice a year to an extent proportionate to the amount of the same year's redemption of the loans and debentures mentioned above.

The Oriental Development Company. The Oriental Development Company is a joint stock company organized in accordance with the Oriental Development Company Act with an authorized capital of 10,000,000 yen, for the purpose of supplying colonization funds and engaging in colonization works in Chosen and foreign territories.

As a natural result of the first part of its purpose, that is, of supplying colonization funds, it partakes of the nature of a banking institution. According to Art. 54 of the Articles of Association of the Company, the funds are to be supplied in the following ways: —

(1) To make loans, redeemable in annual instalments within twenty-five years or on a certain date within five years to immigrants.

(2) To make loans within one year's period, secured by products, to producers or to discount their bills.

(3) To make mortgage loans redeemable in annual instalments within thirty years or on a certain date within five years on real estate, railroads, mining rights or any other rights on real properties.

(4) To make unsecured loans, redeemable in annual instalments within thirty years or on a certain date within five years, to communities or associations relative to industry and organized in accordance with special laws.

(5) To make unsecured loans, redeemable on a certain date within five years, to groups of twenty farmers under joint liability.

(6) To subscribe for, or to underwrite the issue of, bonds and shares of immigration companies or companies engaging in colonization work.

(7) To make loans redeemable on a certain date within five years on the pledge of the above bonds and shares.
(8) To make mortgage loans, redeemable in annual instalments within thirty years or on a certain date within five years, on a trustee property or other reliable objects.

THE YOKOHAMA SPECIE BANK. The Yokohama Specie Bank (Yokohama Shokin Ginko), organized in accordance with the Yokohama Specie Bank Act is a joint stock company with an authorized capital of 100,000,000 yen, fully paid up. Its president and vice-president are appointed by the Government. With its nominal head office in Yokohama and actual one in Tokyo (though it is called a branch), its activities cover the world through its thirty-nine branches, three sub-branches and several agents.

The bank's principal business is: —

(1) To deal in domestic and foreign exchanges.
(2) To make loans.
(3) To receive deposits of money and accept the valuables for safe deposit.
(4) To discount and to collect bills of exchange, promissory notes and other securities.
(5) To exchange monies.

In addition to the above, the Bank is authorized to buy or sell public loan bonds, gold and silver bullion and foreign coins, if its business condition so requires. It may also be entrusted with matters relative to foreign borrowing and with the handling of public money for international account.

MUTUAL LOAN SOCIETIES. The Mutual Loan Society (Mujin) is a credit institution on a mutual basis popular among the middle and lower classes and has more or less the nature of a coöperative credit society.

According to the Mutual Loan Society's Act of June 1915, anyone who intends to engage in this business must as a rule possess property estimated more than 30,000 yen in value. Once sanctioned by the Finance Minister, who has jurisdiction over these institutions, to be an officer, he is not allowed to engage in any other occupation. He is also under obligation to report the

condition of the business to the Finance Minister through a local governor.

The Society's working fund is obtained by members' subscriptions which are paid in instalments during a certain period. There are many restrictions upon the use of such funds. The refunding is done by means of drawings, bidding, or some other means similar to these. The number of lots and the amount of money thus repaid are previously fixed.

Coöperative Credit Societies. Coöperative Credit societies first acquired a new legal status by the promulgation in March 1900 of the Coöperative Societies Act, which has greatly expanded the scope of their business as a result of the revision of the Act in July 1917.

They are authorized to receive savings deposits from their member's family, public corporations or private non-business corporations. The funds thus acquired are to be used in loans to their members in order to improve their economic status.

Coöperative credit societies established in cities designated by the Minister concerned, are authorized, in addition to the above mentioned business, to discount bills for their members and to receive the savings accounts of non-members in the same city.

They are subject to the jurisdiction of both Finance Minister and Minister of Agriculture and Forestry.

Negotiable Paper Instalment Sale Companies. The Act of April 1, 1918 requires the Finance Minister's license for the organization of such companies, the minimum capital requirement of which is set at 10,000 yen. Their scope of business, especially their object of investment is very limited. To carry on any other subsidiary business than allowed in the Act has to be done with the permission of the Minister. They are also under obligation of reporting their business condition semi-annually to the Minister.

Central Chest for Coöperative Societies. The Central Chest for the Coöperative Societies, created by the Act of April 6, 1923, is a central financial body for the coöperative societies with the purpose of regulating the movement of their funds and bringing them into close touch with the central money market. Its authorized capital is 30,000,000 yen, one-half of which is sub-

scribed by the Government and the other by about eighty per cent of all existing coöperative societies throughout the country.

The principal business of the Chest may be outlined as follows: —

1. To make unsecured (in case of necessity, secured) loans redeemable within a period of less than five years, to the combinations of coöperative societies or to its member societies.
2. To discount bills, or to make advances on the current account, of the combinations of coöperative societies or to its member societies. In case of necessity, securities may be required for this kind of financing.
3. To deal in bills of exchange for the combinations of coöperative societies or its member societies.
4. To receive deposits of money from the combinations of coöperative societies, public corporations or private non-business corporations.

The Chest is authorized to issue bonds to an extent not exceeding ten times its paid-up capital.

The Chest is subject to the supervision of both the Finance Minister and Minister of Agriculture and Forestry.

Trust Companies. Trust Companies are regulated by the Trust Business Act of 1922. According to the Act only a joint stock company with a minimum authorized capital of one million yen is entitled to engage in the trust business, provided a license from the Finance Minister who has a jurisdiction over trust companies has been given.

The properties a trust company is authorized to take in trust are limited to money, negotiable papers, monetary claims, movables, real estate, superficies and leases on lands.

As to the administration of properties in trust, there are detailed regulations provided in an Imperial Ordinance promulgated in connection with the Trust Business Act.

Subsidiary business of a trust company is limited to the following: —

1. To receive valuables for safe deposit.
2. To guarantee another person's debt, subject to limitations set by the above mentioned Imperial Ordinances.

3. To act as an intermediary for the deal in real estate.
4. To act as an intermediary for the loan of either money or real estate.
5. To underwrite the issue of bonds, debentures or stocks and to receive the money for its subscription.
6. To take charge of payments of principal, interest or dividends.
7. To act as agents in the acquisition or disposition of properties; adjustment and liquidation of properties; collection of claims; performance of obligations.
8. To engage in the secured debentures trust business in accordance with the Secured Debentures Trust Act.

Trust companies are required to deposit as a guarantee national loan bonds in an amount not less than one-tenth of their capital, in addition to the legal reserve or surplus to which ten per cent of the profits must be set aside at each declaration of dividends until its total equals its capital.

THE WORK OF THE VARIOUS BANKS

General Remarks. Having described so far the history and the present statutory condition of the banking system in Japan, it may not be out of place to add a few pages describing the work of the various credit institutions.

Generally speaking, their functions are more or less similar to corresponding banks in other countries. For instance, the Bank of Japan holds a similar position in the nation's financial organization as that held by the Bank of England in the United Kingdom, or the Federal Reserve banks in the United States. There are, however, some striking contrasts between the Japanese banking system and that of England or America.

The money market in England is controlled chiefly by five large banks, while in Japan there are over two thousand banking institutions, more or less independent. These banks have numerous branches, some widely scattered. In this respect the Japanese banking system is somewhat different from that of the United States where branch banking is limited.

When it comes to banking institutions specializing in the grant-

ing of acceptance credits, their development is far behind that of the New York market, to say nothing of the London market. This may be due to a difference in the evolution of foreign trade financing in Japan. For such acceptance business is really carried on in Japan by the so-called ordinary banks which have close connections with those banks specializing in foreign trade financing.

The Bank of Japan Compared with the German System. As has been described in the foregoing sections, the present note-issue system of the Bank of Japan is modeled after the so-called elastic limit method of the pre-war German Reichsbank, which had been devised in consideration of the bitter experiences of the Bank of England in the crises of 1847, 1857 and 1866. There is, therefore, much similarity between the two systems on the whole, though different in some of their details. As in the case of the Reichsbank the excess issue has become a regular matter for the Bank of Japan rather than an exception. Since 1897, the year Japan adopted the gold standard, there has been only one year, 1903, in which there was no excess issue. Another vital difference between the two systems lies in the so-called proportionate reserve, a characteristic of the German system, but absent in the Japanese system. Another striking contrast lies in the contents of the security reserve against notes in which the Japanese system includes national loan bonds and treasury certificates of indebtedness on account of the scarcity of prime commercial bills in her money markets. The rate of the excess issue tax for the Bank of Japan is, unlike the German system, flexible, though there has never been an instance in which the Finance Minister set a higher rate than the minimum of five per cent. As to the contents of the specie reserve the German system is more liberal than the Japanese, which is limited to gold and silver and in practice to gold alone.

Bank of Japan's Position in the Nation's Financial Organization. Though there are two other banks of issue in the Empire of Japan, which are similar to the Bank of Japan and their note circulation is limited to their respective territories. As a matter of fact, the Bank of Japan stands as a mother bank to the other two. It is really the bank of banks throughout the Empire.

Most of the important ordinary banks as well as the special

banks have current accounts in the Bank of Japan, which serve as their reserve at the same time as a clearance fund for their bills. In addition they are permitted overdrafts with the central bank on the security of public loan bonds and obtain loans from the Bank secured in the same fashion. They can discount at the Bank of Japan their commercial bills bearing more than two endorsers. In case a bill has only one endorser, security is required, which may consist of national loan bonds and also of debentures, bonds, shares or warehouse certificates. The selection of such securities is quite liberal in times of emergency.

In recent years the total deposits of ordinary banks with the Bank of Japan amounted on an annual average to about fifty to sixty million yen. The total amount of their overdraft, which ordinarily is quite negligible, has increased rapidly since the great earthquake of 1923, standing around ten million yen. The annual average of the outstanding amount of bills discounted is from three hundred and fifty to three hundred and sixty million yen, though in the latter half of a year it amounts to almost twice as much as for the first half, due to seasonal demands.

Official Rates and Their Relation to the Money Markets. The official discount rates of the Bank of Japan have little relation with market rates, which always anticipate the former. The change in the official rates has therefore taken place more for the purpose of acting as a warning signal than by reason of an established discount policy. In almost all instances, the change of rates has caused little relative change in the amount of specie reserve held by the Bank of Japan.

When a bank intends to borrow from the Bank of Japan, however, it has to pay the official rate. Consequently, in periods of a scarcity of money, the official rates become the minimum of market rates and in the reverse instance the market rates fall below the official. Such phenomena are reflective of the fact that there is much room left for the development of money markets in Japan, especially in the matter of a discount market.

From 1882 to the end of 1927 there have been some ninety-six changes in the official rates, fifty of which were reductions. Of these reductions, ten took place in March, seven in April, six in May and two or three in other months, except in September which had none. On the other hand, of a total number of increases seven

took place in November, six each in July, September and October, while only one in April. This reflects vividly the tendency of interest rates in the money markets of Japan which is high in autumn and low in the spring.

In the large cities, however, the above tendency is more or less modified due to the over-seas trade. In Osaka, the center of the cotton spinning industry, tight money usually prevails from April to July on account of an increased demand for money caused by the cotton imports. In Tokyo and Yokohama, the import silk markets, the money generally tightens from June to September, due to the exportation of silks, which usually increases in the fall.

RECENT CHANGES IN THE RATES OF THE BANK OF JAPAN

Date of Change	Discount of Commercial Bills	Discount of Bills with Gov't Bonds as collateral (Minimum)	Discount of Bills with Other collateral (Minimum)	Overdrafts
	%	%	%	%
July 6, 1914	7.30	7.30	7.67	8.40
Apr. 17, 1916	6.57	6.57	6.94	7.67
July 5, 1916	5.84	5.84	6.21	6.94
Mar. 16, 1917	5.11	5.11	5.48	6.21
Sept. 16, 1918	5.84	5.84	6.21	6.94
Nov. 25, 1918	6.57	6.57	6.94	7.67
Oct. 6, 1919	7.30	7.30	8.03	8.40
Nov. 19, 1919	8.03	8.03	8.76	9.13
Apr. 15, 1925	7.30	7.30	8.03	8.40
Oct. 4, 1925	6.57	6.57	7.30	7.67
Mar. 9, 1927	5.84	6.21	6.57	7.30
Oct. 10, 1927	5.48	5.84	6.21	6.94

N. B. The Bank of Japan Rates are given on a per diem basis, as in the case of all other short term rates, such as, 2 sen which means 2 sen (1 yen = 100 sen) per 100 yen per day. The above quoted figures are conversions of these per diem rates into per annum percentages.

As to the causes of higher money rates prevailing in the fall and winter seasons, many factors may be mentioned, such as, tax payments, crop movements, purchases of winter apparel, the New Year's holidays and the semi-annual declarations of divi-

dends by various companies. The regular sessions of the Imperial Diet close by the end of March, resulting in taking away from the market any uneasiness caused by political conditions. As there is little Government enterprise initiated in April, which is just the beginning of the fiscal year, and as less money is needed for the purchase of spring apparel, these facts tend to ease money rates during the spring and summer.

Agreement on Deposit Rates in Other Banks. With the purpose of avoiding unnecessary competition most of the ordinary banks as well as special banks in various cities have entered into some agreement on the rates of interest to be paid to their deposits. There are two types of agreements; one is among the so-called Class A banks, or major banks, and the other for Class B, or minor banks. The latter rates are as a rule higher than the former.

DEPOSIT RATE AGREEMENTS IN RECENT YEARS

(Among Class A Banks of Tokyo and Osaka)

Type of Deposit	Calculation Basis	Dates of Changes				
		Feb. 1, 1920	Mar. 1, 1921	Aug. 1921	Apr. 1, 1922	Feb. 9, 1927
Fixed	Per cent per annum	6.5 %	5.7 %	5.2 %	6.0 %	5.5 %
Current	Sen per 100 yen per diem	1.0 sen	0.7 sen	0.6 sen	0.6 sen	0.5 sen
Special Current	Sen per 100 yen per diem	1.4 "	1 1 "	1.0 "	1.1 "	1.0 "
Time (Notice)	Sen per 100 yen per diem	1.[illegible] "	1.2 "	1.1 "	1.2 "	1.1 "
Savings	Sen per 100 yen per diem	1.4 "	1.4 "	1.4 "	1.4 "	1.4 "
	Per cent per annum	5.5 %	5.5 %	5.5 %	5.5 %	5.5 %

Various Kinds of Deposits. There are several kinds of deposits of money received by the ordinary banks in Japan. The current deposit corresponds to the so-called check account in America, but the use of checks for daily transactions has not developed to any extent. Therefore, a much lower free balance (at the end of 1927 about 500 yen) is required and higher rates of interest are paid than those prevalent in America. Special cur-

rent deposits may be regarded as a kind of savings deposit, usually with a close connection with the household economics. It naturally has a less frequency in withdrawals and, therefore, higher rates of interest are paid than on current deposits. The minimum balance for this account is about ten yen. Time deposits or fixed deposits are deposits withdrawable upon notice. The amount of such deposits is generally large and naturally a higher rate of interest is paid than in the case of any of the foregoing deposits. Fixed deposits are one form of deposit most popular in Japan, and indeed more than half of the total amount belong to this class. It is not withdrawable before a fixed date. The minimum period is, according to the present agreement, six months. At times such deposits may be money deposited by local banks with banks in some money center as their reserve. At other times it may represent money deposited by individuals or firms for the purpose of investing their temporary idle funds. The nature of the deposits being such, naturally the rate of interest paid is the highest of all and it has to keep pace on the whole with the yields of public loan bonds or those of other securities. The popularity of this type of deposit is one of the principal reasons for the higher money rates prevalent in Japan. The eventual remedy must await the sound development of a bond market.

Types of Loans. The types of loans recognized in the laws of Japan are more or less similar to those in other countries. The most popular form of loan is the loan made against bills of exchange or promissory notes to which almost one-half of the total amount of loans made by ordinary banks belongs. The usual life of such a loan is from sixty to ninety days. The interest is paid in advance and one day's interest doubles at the renewal of loan. The notes given as security are easily convertible into money. These facts tend to lower the rate of interest paid. In conclusion, the most popular form of loan is the discount of bills of exchange which comprise about 40% of the total amount of all. Then come call loans, or loans on certificates, each occupying about 10%. The overdraft is the most unpopular form and its ratio is smallest of all.

Loans on certificates are loans made against ordinary certificates of indebtedness or on notarial deeds; such as, long term real

estate or factory mortgage loans. The period of such loans is usually six months, though sometimes it runs up to one or two years. Factory mortgage loans usually take place in a case when a certain manufacturing firm intends to obtain for a temporary period its working funds with the expectation of refunding at the earliest profitable chance into long term bonds. Strictly speaking, this is not the type of loan to be advanced by commercial banks. Anyhow, at present the highest rate of interest is paid on it and the rate is little affected by current money market conditions. The interest is payable with the expiration of the loan.

Standard Rate on Loans. The financial position of the cotton spinning companies in Japan has increased in strength year after year. Their bills, commonly known as cotton bills and usually of short term, have come to be regarded by our commercial banks as prime bills and the Bank of Japan is always ready to discount them. This phenomenon tends to lower the rate of interest on these bills, which sometimes shows a differential of 0.004 yen per day per every hundred yen lower than that of other commercial bills. It might, therefore, be said that the standard rate on loans in Japan, especially in Osaka and Tokyo is the daily discount rates prevailing on these cotton bills.

Clearing Houses. The first clearing house in a modern sense was founded in December, 1879 in the city of Osaka, where even long before the Restoration merchants had been accustomed to the use of checks, bills, etc. In Tokyo the clearances were commenced in December, 1887. Both of them, however, were later replaced by new institutions modelled after the system existing in London. Thus, the present Tokyo Clearing House dates back to March, 1891 and the Osaka one, to April, 1896. Since then many of the local money centers imitated the examples set by these two leading cities. The total amount of bills cleared has steadily increased as the table on page 868 shows.

The members of the Tokyo Clearing House meet every business day at 10.30 in the morning and a general settlement takes place half an hour later at 11 o'clock by means of a transfer in their current accounts at the Bank of Japan. Dishonored checks, bills, etc., are returnable for settlement until 3 p.m. of the same day. Other procedures are adopted chiefly from the London system.

Year	Number of Houses	Total Number of Bills	Amount Cleared (In 1,000 yen)
1880	1	87,556	35,918
1890	2	165,773	57,453
1900	6	3,827,645	2,619,737
1910	7	8,105,368	8,216,080
1915	11	11,191,565	11,625,720
1920	13	26,105,702	74,068,745
1925	19	34,612,430	83,511,555
1926	26	37,970,418	88,964,098
1927	26	31,146,737	62,435,061

CHAPTER XII

THE BANKING SYSTEM OF NORWAY

BY

HAROLD SWENSON

THE MONETARY SYSTEM

Norway, along with Sweden and Denmark, is a member of the Scandinavian Monetary Union, which was organized in 1873. Gold is the monetary standard and the crown or krone of 100 ore is the currency unit in the three countries. The par value of the krone is $.268 in United States currency. Gold does not circulate itself, the common means of payment being bank notes, issued solely by Norges Bank (the State Bank of Norway), and redeemable in gold. Before the war the bank notes of the central banks of Sweden and Denmark were frequently seen in Norway, where they circulated on an equal basis with the notes issued by the Norges Bank. The monetary disturbances of the war, however, and the consequent suspension of specie payments, changed this with the consequence that the Danish and Swedish bank notes were treated on a premium and discount basis as those of any other currency.

Like the state banks of most other countries, the Norges Bank suspended specie payments soon after the outbreak of the war, and the right to issue paper money was considerably extended by special legislation. Specie payment was first suspended on August 18, 1914, resumed again on March 8, 1916, and suspended for the second time on March 19, 1920, which suspension is still in force.

FLUCTUATIONS IN NORWEGIAN EXCHANGE. During the first few years of the war the Norwegian exchange rose above par and Norway's financial position was so strong that loans were made to foreign concerns, principally to French and British (Hambros Bank Ltd., London). It was the prosperous shipping trade that

placed Norway in this position, but with the post-war decrease in the earnings of this industry, the Norwegian exchange declined rapidly. It reached its low point during the fall of 1920, when Norwegian exchange was quoted in New York as 11.70, compared with a parity of 26.80. Since then it has gradually moved upwards. For a long time it remained about 15 dollars for 100 kroner, but international speculation in 1924 and particularly in 1925 brought it up to a level somewhat above 20 dollars.

It must be noted, however, that this rise was not primarily due to an improved financial condition in Norway, but to international speculation. The deposits of foreign banks in Norway during the last six months of 1925 were abnormally high. The unexpected rise placed Norwegian export and shipping in a difficult position and it also handicapped other industries. The management of the Norges Bank made energetic efforts to check this artificial development, but only with partial success. During 1925 and 1926 Norwegian exchange moved more or less in sympathy with the Danish, the belief of foreign speculators being that both countries would in the near future put their currencies back to the gold basis.

Special Exchange Commission. At the end of 1925 conditions in Norway were so serious that a special Exchange Commission had to be appointed to study the problem. Its recommendations were published at the end of January, 1926, and, in brief, they were in favor of a temporary stabilization at the present level, i.e., about 20 dollars to 100 kroner. This report was most extensively commented upon, approved by some and criticized by others. In the meantime, however, a fresh wave of speculation set in and by March, 1926, the exchange had reached almost 22 dollars to 100 kroner.

In the fall of 1926, soon after the Danish Government had announced its intention of bringing the Danish exchange bank to a gold basis as from January 1, 1927, the Norwegian krone experienced several violent rises, and in December, 1926, it was quoted in New York at above 25 dollars. The prevailing opinion in the financial world was that Norway would follow Denmark's example and bring its currency up to par in the near future, a step which was advocated by several Norwegian interests. The president of the Norges Bank, however, declared that the time for

such a stabilization was not as yet opportune, and although there is at present no doubt that the Norwegian exchange will ultimately be brought back to par, it is difficult to predict any definite time for such action.

During the discussions of the revaluation of the Norwegian krone, a dissolution of the Scandinavian Monetary Union was considered. With the Norwegian exchange now rapidly striding towards par, the probability is that the Scandinavian Union will again become operative as soon as Norway and Denmark return to the gold standard. In the case of Denmark the date for the resumption of the gold standard has been set for January 1, 1927. Norway, however, does not seem very anxious to follow the Danish example in the immediate future, probably on account of her present unfavorable economic conditions.

CREDIT SYSTEM

Forms of Credit. The ordinary method of granting credit in Norway has been through accommodations on open-account. Some of these have been secured by collateral or guaranties, but more often the credits have been extended simply on the standing capacity and estimated solvency of the borrower.

In Norwegian bank statements this item is usually called " cash credit " or " miscellaneous debtors " (accounts receivable). The term " cash credit " was introduced in Scandinavia about 1830 from Scottish banking practice, and originally signified only advances secured by personal guaranties and other collateral. Lately this term has been frequently used to designate unsecured advances on current account. The practice of granting unsecured, or insufficiently secured, loans has proved to be fatal in many cases and has been one of the principal reasons for the many failures among the Norwegian banks recently.

Another credit instrument in much favor in Norway is the indorsed promissory note, in Norwegian called " vekselobligasjon " (bill of exchange bond). Together with the ordinary promissory notes and bills of exchange they constitute the principal part of a bank's discounts. These instruments are, of course, negotiable, but usually they do not leave the portfolio of the

bank until they are redeemed or renewed, except when the bank is in need of funds, at which time some of those discounted items are rediscounted with the central bank (Norges Bank).

The business of financing and developing trade and industry by the banks in Norway is reflected by the loan totals of the banks, and, in particular, by the increased ratio of loans to total deposits, compared with the volume of bills discounted. This trend is shown by the contrast in bank returns for 1910 and 1915 which indicate that loans equaled 44 per cent of deposits in 1910 and jumped to 59 per cent in 1915. This development continued at an accelerated pace in the years following, the "bills discounted" becoming relatively less and less in importance, with a consequent reduction in the liquidity of the banks. It must also be noted that cash reserves, as true under Continental practice, were at no time required to be held at the high proportion required in the United States and common to commercial banking practice in Great Britain.

Negotiable Instruments. The law regarding negotiable instruments is practically alike in the three Scandinavian countries. According to this law a Bill of Exchange is an absolutely unconditional instrument, the legal requirements of which are the following:

(a) The document must in the text be described as a bill of exchange.

(b) The amount of money to be paid must be stipulated in fixed terms. If the bill is drawn in a foreign currency, it is unnecessary to stipulate that it is payable at the collecting bank's selling rate for the exchange in question, as the law prescribes that the official rates be used. The liquidation of the bill must be effected in one payment. An "interest clause" should not be added on Scandinavian bills, as the law stipulates that any such remark will be considered "as not written." It does not, however, render the bill void.

(c) The name of the person to whom payment is to be made. Consequently, a Scandinavian bill of exchange may not be drawn to bearer.

(d) The name of the drawee.

(e) The bill must state when and where issued.

(f) It must also contain the place of payment. Unless otherwise stated, the address of the drawee is considered the place of payment.

(g) The name of the drawer.

A comparison of the legal requirements of the Scandinavian and American laws of bills of exchange will reveal the following fundamental differences:

The Scandinavian bill of exchange must stipulate time and place of issue, place of payment, and also state that it is a bill of exchange. These three stipulations are not considered essential according to American law.

On the other hand, the American negotiable instruments law requires that the instrument be made payable on demand, or at a fixed or determinable future time, which stipulation is not considered essential according to the Scandinavian law, which states that if no mention is made regarding maturity, the bill is to be considered payable on demand.

THE BANKING SYSTEM

THE CONTINENTAL SYSTEM. The commercial banking practice in Norway is based on the so-called Continental or German system. The banks not only finance current trade transactions, but also supply capital funds for commercial enterprises through capital credits, bond flotations, and share-issuing operations.

This practice naturally impairs the liquidity of the assets, so that a comparison with American banks in that respect could scarcely be made. It is rather difficult for an American banker to read a Norwegian bank statement, as it cannot be analyzed from the same point of view. To an American banker, the Norwegian banks would probably seem continually overloaned owing to a constant excess of loans and discounts over deposits, unless allowance were made that a very small proportion of the deposits are of the "demand" classification. The relatively small proportion of liquid assets, and the small ratio of cash in proportion to deposit liabilities are all explained by the difference between the Continental and the American banking system. The Conti-

nental banking system has been severely criticized on account of its inelasticity and the inherent weakness of deficient liquidity in event of trade depression and rising demand for a withdrawal of deposits. On the other hand, it must be admitted that the great economic development and the rapid upbuilding of industry in Northern Europe is in a great measure due to the successful use of the Continental banking system.

Decentralization. The outstanding characteristic of the Norwegian banking system is its decentralization — the large number of independent banking institutions, each serving the economic requirements of a local field, independent of connections or affiliations with other banks in other parts of the country. The branch banking system, with its concentration of power and distribution of effort and risk, has had but little development in the country. The larger banks have made various attempts to introduce the branch system by establishing a few home-city and out-of-town branches, but they do not seem very successful in acquiring support for their branches on account of the disinclination of the people to support banking institutions of other than local origin.

In 1915 the total number of commercial banks in operation was 127 independent institutions with 17 branches. The number of banks increased rapidly during and shortly after the war and reached a peak in 1918 with 200 independent banks. At the same time the number of branches amounted to 28. By 1923 the total number of banks had decreased to 170, while the number of branches had increased to 74, of which 20 were home-city branches and 54 out-of-town branches. As a result of the many bank failures in 1923 several branches were abandoned, and the tendency at the present time seems to be that of establishing new local banks in place of those that failed instead of branches of the larger banks.

No coöperative banks have been established as yet. The coöperative movement in Norway has not made much progress. During the war several coöperative stores were established, but most of them have since been forced into bankruptcy.

Banking Laws. One of the peculiarities in Norwegian banking up to a few years ago was the total lack of banking laws and bank supervision. There were no regulations to govern the opera-

tions of commercial banks and periodical examinations of banks were unknown. When organizing a bank, the only law to be complied with was the law governing the joint-stock companies. It is quite true that there was a savings bank law, but its requirements were less rigid and the control much more lax than similar measures in the United States.

In 1918 a temporary law was passed making the establishment of new banks dependent upon the sanction of the Government. Increases in capital of banks already established were also made subject to governmental approval. This law covered all institutions doing a banking business with the exception of those institutions already governed by separate laws, viz., the Norges Bank, the Mortgage Bank, the Farmers' Bank, and the savings banks.

The rapid increase in the number of commercial banks during the war, and the circumstances under which some of them were established and operated, stressed the necessity of drafting a comprehensive law governing these institutions.

Joint-Stock Banking Law. A small committee was appointed by the Ministry of Finance on February 1, 1919; and on February 14, 1920, this committee submitted a proposal for a joint-stock banking law. Several changes were made subsequently, mostly on recommendations submitted by the Norges Bank and the Norwegian Banking Association, and the law was sanctioned on April 4, 1924, and went into effect on January 1, 1925.

This law, which takes the place of the temporary law of 1918, provides that a bank must be a joint-stock company with a minimum of ten shareholders, all of whom must be resident Norwegian subjects. Any bank having foreign shareholders must report this fact to the bank inspection. In order to be registered in the Commerce Registry a bank must have the sanction of the King, who incidentally has authority to rescind such sanctions. Any increase in capital, change in statutes, or establishment of new branches must also have the approval of the crown.

The King may grant permission to a foreign institution to do banking business in Norway, provided that Norwegian banks have a corresponding right in the foreign country in question.

In all such cases the Norges Bank is given an opportunity to express itself before the King makes any decision.

The capital stock must not be less than Kr. 400,000, though

exceptions may be made by the King. The par value of a share of stock must not be less than Kr. 100. The law further contains many regulations regarding organization of banks, their operations, dissolution and amalgamation. There is a separate section on bank inspection and numerous stipulations concerning the new law's application to banks already in existence.

While in some quarters this law is considered too rigorous, it is generally agreed that the recent experiences fully warrant its provisions, particularly in respect to the management of banks and the granting of loans.

NORGES BANK

History. The Norges Bank, with its head office in Oslo, is the central bank and note-issuing institution of the country. When Norway regained her full independence in 1814 after the long connection with Denmark, her economic condition was most unsatisfactory. Trade and shipping had been ruined during the period of the war, and to make matters worse, the Danish State Bank, which had also been the bank for Norway, had become bankrupt in 1813, and its notes, of which an enormous number had been issued, had become practically worthless. The British blockade and failure of the harvest in 1814 had brought the people to the verge of starvation. Of banks there were none and the commercial houses which had lost heavily were powerless to prevent the disaster which threatened to make a complete wreck of the country.

The most urgent and at the same time the most difficult task to which the Storting (the Norwegian parliament) of 1816 had to devote its thoughts and constructive energy, was to reorganize the currency of the country. It was recognized that the first thing was to establish a solid bank to be intrusted with the note-issuing power, but so disheartened were the people that many doubted if it would be possible to raise the necessary capital.

The Storting, however, on June 14, 1816, passed an Act by which it was decided that such a bank should be organized. Public subscriptions for 2 million specie dollars, equal to 8 million kroner, were invited, but in case this appeal should fail, a measure

was enacted to levy forced contributions. This latter expedient had to be resorted to, and though severe measures were used, not more than 1,200,000 specie dollars could be obtained from the impoverished country.

It was therefore under most unfavorable conditions that the bank opened for business on January 25, 1817, in Trondhjem, which had been selected as its seat. Considering the economic situation and the fact that banking principles were not fully understood, there is little cause for surprise that many mistakes were made. For fear of losing the little hoard of silver which had been collected with so much trouble and loss, it was enacted that the bank should not be compelled to pay silver for its outstanding notes. The consequence was that they fell to a discount, and not until 1842, when an act providing for cash redemption of outstanding notes was passed, did they reach par. Since then the currency system of the country has rested securely upon the convertible notes of the Norges Bank.

In more recent years the Norges Bank has ably fulfilled the important functions which the State placed upon it as the regulator of the economic and financial activity of the nation. The usefulness of the bank has grown with the economic development and progress of the country. On January 1, 1897, the head office of the bank was removed to Oslo, the capital of the country.

Organization and Control. The Norges Bank is controlled by the Government. The management is in the hands of a Board of Representatives and a Board of Directors. The Board of Representatives consists of 15 members and the Board of Directors of 5. In addition, each branch has its local Branch Board, consisting of three members. The Board of Representatives is elected by the Storting for 6, 7, or 8 years. The president and vice-president are appointed by the Crown and the other directors are elected by the Storting. The branch managers are elected by a committee of Parliament.

The present capital is 35 million kroner with reserves exceeding 15 millions. Norges Bank issues bank notes in the denominations of 1,000, 500, 100, 50, 10, and 5 kroner. On account of the hoarding of silver coins, a dearth of fractional currency developed during and immediately after the war, and the bank then received authorization to issue notes in the denominations of 1 and 2

kroner. These small bills were of a temporary character and printed on inferior paper, and as the country has practically no need for them at the present time, they are being withdrawn by the bank.

The Norges Bank maintains 20 branches in the following cities: Aalesund, Arendal, Bergen, Bodö, Drammen, Fredrikshald, Frederiksstad, Gjövik, Hamar, Hammerfest, Haugesund, Kristiansand S., Kristiansund N., Larvik, Lillehammer, Skien, Stavanger, Tromsö, Trondhjem, and Vardö.

By the Amendment to the Bank Act of 1912 the following stipulations regarding distribution of profits were made: the stockholders are entitled to a 6% dividend per annum, one-half of the remainder goes to the Treasury; then a further 3% to the stockholders, $\frac{3}{4}$ of the balance to the Treasury and $\frac{1}{4}$ to further dividends.

Operations. According to the statutes of the bank of April 23, 1892, with modifications and amendments of 1896, 1900, 1902, and 1905, it may engage in the following transactions:

1. Grant time loans not exceeding six months; the shares of the bank may not be used as collateral.
2. Discount bills of exchange and promissory notes, payable within the country, with a maturity of not more than six months.
3. Open current accounts for a maximum of one year against collateral or mortgage.
4. Buy and sell foreign bills of exchange.
5. Buy and sell gold and silver bars.
6. Make investments in Norwegian Government bonds, as well as in other domestic or foreign interest-bearing securities, which are quoted officially on the foreign exchanges and which are readily marketable.

The Norges Bank may accept deposits from foreign banks, but is by law prohibited from paying interest thereon. In a general sense it does not compete with the commercial banks, as it is more concerned with government finances, with the supervision of reserves, and with rediscounting than with a general commercial business.

The operations of the Norges Bank can hardly be compared with those of the Federal Reserve Bank. The Norges Bank lacks the broad powers of the Federal Reserve Bank in regulating money and credit; money markets in the American sense of the word are practically absent and the Norges Bank does not undertake the clearing and collection of checks. The latter function has been left to the private banks themselves; a clearing house has been established in Oslo, but the great bulk of the checks are sent direct to the drawee bank for collection.

The Norges Bank is naturally the chief depository of the Treasury. In conjunction with the Ministry of Finance it takes care of all Government receipts and disbursements and in general acts as an advisor to the Government on financial matters.

Note-Issuing Privileges. The Norges Bank may issue bank notes exceeding its gold in vaults up to 250 million kroner. During recent years, however, this limit has proved to be inadequate and a special note-issuing privilege was obtained. This special permission has been reduced gradually, and at the present time amounts to but 25 million kroner. On the latter amount a tax of 1% is paid to the national treasury. To sum up, the Norges Bank may issue notes to the extent of its gold holdings plus 275 (250 plus 25) million kroner. Note circulation has decreased considerably during the last couple of years. In June, 1925, the notes in circulation amounted to Kr. 387,000,000; on June 30, 1926, had been reduced to Kr. 343,000,000, and in November, 1926, the total was 315 million kroner, compared with a figure at the end of June, 1914, just before the war broke out, of 124 million kroner. In this connection it may also be mentioned that the gold reserves now amount to 147 million kroner, compared with 44 million in June, 1914. The note reserve during the last few months have been around 100 million kroner.

COMMERCIAL BANKS

While considered theoretically as two different forms of banking, no sharp distinction can be drawn between commercial and savings banks, as their operations frequently overlap. Especially during the war several savings banks were attracted by the larger

profits and entered the commerical banking field. For most of these savings banks the step proved to be disastrous when the crisis came in 1920 and 1921, and several had to suspend payments. On the other hand, the commercial banks have for many years keenly competed with the savings banks for the small individual savings accounts in addition to their ordinary commercial transactions.

History. Private banking in Norway is of comparatively recent growth. It was only in 1848 that the first private bank was organized, the Christiania Bank og Kreditkasse, originally started as an institution for the granting of loans against securities in the form of goods, stocks, or bonds. This institution rather quickly developed into what we might term a modern bank. In the meantime Bergens Privatbank was founded in Bergen in 1855, and Den Norske Creditbank in Oslo in 1857. From then on private banks were established in several towns. The history of Norwegian private banks, therefore, is not more than sixty to seventy years old, but in this short period Norwegian banking has successfully passed through many crises.

Bank Failures. The first bank failure in Norway occurred in 1886, when a small and unimportant bank in the town of Arendal had to stop payments owing to frauds on the part of the bank manager. In 1889 another local bank failed, and in 1908 a small bank in Fredriksstad had to close. It might be mentioned that in the years 1890–1900, Oslo was struck by a banking crisis which was of no consequence, however, to the older banking institutions, but only concerned the newly established speculative enterprises, an affair, which was of an entirely local nature, and did not play any part so far as the bulk of Norwegian banking was concerned.

From this it will be noted that Norway has had no serious banking crisis until after the war, and the above are only scattered examples of Norwegian banks having encountered difficulties in commercial connections. On the other hand, it is well known that America, England, and the Continent have repeatedly been involved in great banking crises, but such has not been the case in Norway. So the more regrettable was it that the great post-war crisis should most seriously ruin the good reputation which Norwegian banks had acquired through sixty to seventy years of

cautious management. Unfortunately, they suffered from various weaknesses during the tremendous decline in the various branches of Norwegian trade which threatened to be fatal.

It is hardly possible for foreigners to form a just idea of the degree to which Norwegian trade was injured by the international crisis in 1920–21. There is, perhaps, no country having a trade life more susceptible to changes than Norway. In order to understand this, it must be remembered that the economic life of Norway is based on: (1) agriculture, (2) wood-working industries, (3) fishing, (4) mining, and (5) shipping. Practically all of these suffered an enormous drop in prices in the latter part of 1920. After the war Norway lost her principal markets for export of fish products, and the fall in freight quotations affected Norway more seriously than any other country on account of the very important part which the income from shipping has always played in the country's finances.

It is evident that with the chief industries of Norway simultaneously struck by the most vehement crisis ever experienced, the banks could not avoid being entangled. However, it must not be denied that the banking business itself had entered upon a distorted course of development which contained germs of danger and disaster. Thus there was the extremely rapid organization of new banks during the war. While in 1915 Norway had only 122 private banks, the number in 1918 had risen to no fewer than 200. In the course of one year, 1917, 22 banks were founded, and in the following year, 1918, the number was increased by 40. It is manifest that during periods of depression there would not be sufficient business for so many institutions. Some banks were naturally destined to fail or liquidate, which would disturb and bear hard upon the older institutions.

Then the extremely keen competition between the banks made their power of resistance far weaker than it had ever been. In Norway, as elsewhere, we differentiate between two sorts of deposits, viz., deposits at call and deposits on notice. Of the latter, there are several sorts, but the so-called " deposits on savings banks' terms " make up the great bulk of the total amount of bank deposits of the country. These deposits cannot normally be entirely withdrawn unless notice has been given three months in advance. Only small amounts are paid out on application at

once, as a rule not to exceed 200 kroner on each account. The competition between the new banks and the old ones brought it about that the public could generally expect to have their deposits paid out at any time without previous notice.

The Public Administration Law of March 24, 1923. The weaknesses of Norwegian banking became evident first in July, 1920, through the suspension of a small unimportant bank in the northern part of Norway, largely due to the difficult position of the fishing industry and also to unsuccessful transactions in Russian roubles. During the fall of 1920 several banks had to be reorganized, but they were able to continue operations uninterruptedly. In January, 1922, several new banks became involved in difficulties and had to be reconstructed or liquidated. It was not until the early part of 1923 that the Government realized how serious the situation really was. As soon as it became known in parliamentary circles that a catastrophe was inevitable, the act known as the " Public Administration Law of March, 1923," was hurried through in order to reduce somewhat the severity of the crisis.

The principal aim of this act is to secure a bank which has had to suspend payments, against losses which unquestionably accompany a sudden interruption of activities and the accompanying liquidation. According to the new law, a bank in difficulties may continue business under public administration and all new claims enjoy preference in case of subsequent liquidation. Later the Government also agreed, in the case of the two largest banks under such administration, viz., Centralbanken for Norge, Oslo, and Andresens og Bergens Kreditbank (Foreningsbanken), Oslo and Bergen, to guarantee all new obligations entered upon by these banks, not only new deposits, but also other new liabilities.

Depositors and other creditors may have part of their claims paid out to them, and so enjoy all the advantages of bankruptcy proceedings, and have, moreover, the great advantage that the bank in question is safeguarded against the losses which might otherwise occur. In addition to this there is the hope that the bank may ultimately be reconstructed on a safe basis.

There is no doubt that the Public Administration Law has been of great benefit to Norwegian banking on the whole, and has

avoided what might otherwise have resulted in a general breakdown of the entire banking system of the country. Up to the end of December, 1926, 40 private banks and 11 savings banks have been placed under public administration. Most of these banks still continue to operate and in several cases it is doubtful whether they will be reconstructed or liquidated, as the opinion of the depositors and creditors is very much divided. Of the above-mentioned 51 banks only two have hitherto been able to resume free activity, viz., Aalesunds Kreditbank, Aalesund, and Skudesnes Privatbank, Skudesneshavn; about 15 have been liquidated, and the remainder have obtained extension of the administration period.

The Norwegian Public Administration Law of 1923, a translation of which follows, is an interesting document, not only from a legal standpoint, but also from the economic:

1. When a joint-stock bank or a savings bank has suspended payments, and when it is considered necessary for the benefit of the creditors and in public interest to avoid liquidation, the Ministry of Finance can decide that the bank shall be put under public administration up to one year, provided the application from the bank involved bears the recommendation of Norges Bank.

2. As soon as the Ministry of Finance has decided upon such a course, the Norges Bank shall appoint the Board of Administration and an Auditing Committee for the bank after the Board of Directors has been given an opportunity to express itself on the subject. The Board of Administration and Auditing Committee shall each consist of at least three members, of whom one will be appointed chairman. Furthermore, secondary members will be elected simultaneously. Members of the Board of Directors and officers may be elected as members of the new bodies, as stated above.

3. The Board of Administration shall immediately publish a statement to the effect that the bank is under public administration. This publication shall appear in " Norsk Kunngjörelsestidende " (an official publication) and in one or more newspapers commonly circulated in the locality, also the courts shall be advised in the community where the bank is an owner of real estate. Furthermore, the Board of Administration will duly notify the Commerce Registry that the bank is under public administration, indicating those who have been elected as members of the Board of Administration and the Auditing Committee.

4. From the time the application has been lodged in accordance with the rules set forth in paragraph 1, or delivered to the post or telegraph office, and until the application has been rejected or until the public administration is being discontinued, no attachment can be made in the properties of the bank and no forced sales can take place, unless a fully legal lien has been acquired before that time. During the same period the bank can not be declared bankrupt, even though an application in this respect may have been lodged previously. Claims, which have been acquired by the debtors

of the bank after payment was suspended, can not be used as payment of debts to the bank.

5. The Board of Administration shall within three months from appointment send to the Ministry of Finance and to the Norges Bank a complete report as to the position of the bank, describing the policy which the Board of Administration has adopted. The report referred to shall also contain an expression of opinion from the Auditing Committee. The Ministry can demand a new quarterly or semiannual report, and additional information and can institute investigations. If the Norges Bank proposes to amend the policy, the Ministry may decide to alter the working plan. Statements and balance sheets may be published by the Ministry and the Board of Administration whenever such publication is deemed advisable.

6. During the period of administration, the bank's Board of Directors and management must resign, but they are obliged to assist the Board of Administration and to furnish all information which is required by the administrators and auditors.

7. The Board of Administration conducts the activities of the bank, and the chairman or two of its members sign for the bank with binding effect. Instructions with reference to the control and auditing are issued by the Ministry.

8. During the period of administration, the activities of the bank are to be continued to such an extent as the Board of Administration deems advisable, giving due consideration to the interests of the creditors. Claims which are based on new deposits or on other ordinary banking transactions have a preference before old claims, if the bank should later on be declared bankrupt. Separate records are to be kept covering all new transactions.

9. Matured bills and other instruments on which the bank is liable can be renewed, provided this can be done without cost to the bank. However, it must be expressly noted that such renewal shall not give the creditor any advantage or the debtor any disadvantage with reference to payment if renewal had not taken place. Matured bills, which in case of bankruptcy are considered preferred claims, or debts which are secured may be paid.

10. Deposits or other interest-bearing claims before the time the application for administration was lodged, will be subject to a rate of interest of 2 per cent below the discount rate of Norges Bank. Payments can be made by installments of such obligations, but not to any larger extent than the Board of Administration finds strictly necessary, and not with larger amounts than with safety can be expected as dividend in case of bankruptcy. The installments with additional interest of 4 per cent will be considered as an advance dividend, which finally may be arrived at during bankruptcy proceedings.

11. On the application of the Board of Administration the Ministry of Finance can extend the year of respite for one year at a time. They may also at any time, on the proposal of Norges Bank, instruct the administration to enter into negotiations for composition or surrender the bank to bankruptcy.

12. At the close of each year, as well as at the end of the period of administration, the Board of Administration shall as soon as possible submit to the Ministry of Finance revised statement. The statement must be supplemented with an expression of the Auditing Committee, and has to be published in the manner prescribed in paragraph 51 of the Norwegian law on joint-stock companies.

13. Provisions of paragraph 289 of the Norwegian Penal Law shall be in force when a bank is put under governmental administration according to this law.

14. If a proposal for composition which is conditional upon the acquisition of new working capital is advanced by a bank carrying on public negotiations for composition, or which is in bankruptcy, and if the proposal for composition and the plan for reconstruction is recommended by the committee managing the composition or the manager of the estate in bankruptcy and the committee of creditors and, in addition, approved by Norges Bank and the Ministry of Finance, the composition can be confirmed by the Court of Bankruptcy when the proposal is accepted by the majority, calculated, in conformity with legislation, on the amount of the claims, even if there is not a majority in numbers.

15. In the case of such a composition, reserve can be taken that later claims shall have precedence of the claims which are included in the composition if the bank becomes bankrupt before the composition is completed. The provisions contained in paragraph 10, second part, may be used in the same way. The Bankruptcy Court can, when dealing with banks as named in paragraph 14, prolong the periods of respite for advancing and treating proposals of composition. Meetings, however, for deliberations on such proposals of composition may not be held later than one year after the opening of the negotiations for composition.

16. The right of debtors to place their claims into account against a bank under administration, which is founded on the law of bankruptcies (par. 119) and the law of compositions (par. 30), may not be applied in the case of claims which have been acquired after the bank had stopped its payments.

17. This law is to come into force immediately. Provisions of paragraphs 14 and 15 are to be applied also when negotiations for composition or bankruptcy have been opened at an earlier date. When in such a bank under composition a new proposal for composition is being intended, according to paragraph 14 of this law, the Board of Composition must summon a new meeting, as pointed out in the law of compositions (par. 6). A bank which is passing from negotiations for composition to administration, according to this law, may not be submitted to the provisions of the law for compositions (par. 31).

In order to avoid an interruption of regular business transactions with foreign banks, the Government found it necessary soon afterwards to pass an amendment to this act extending governmental guaranty for the prompt fulfillment of old engagements arising from the movement of goods; i.e., documentary credits and export bills. The entire law was revised in the beginning of 1925 and several new stipulations covering the liquidation of banks were added.

The most recent indications are that this law will soon have to be remodeled, for it has many features disadvantageous to banks in free activity. It is quite likely that the " free " banks in Norway will shortly petition the Ministry of Finance to repeal this

emergency measure. Of the banks placed under public administration about 15 are already liquidating and it is expected that more will follow as soon as the extension periods for administration are shortened.

Among the changes desired in this law are the prohibiting of the acceptance of deposits on the part of a bank under administration and of the transacting of business for new customers (except under extraordinary circumstances). Also a fixed time limit should be placed within which a definite decision should be reached as regards the continuance or liquidation of the bank.

Mergers and Amalgamations. It was not until 1919 that the consolidation movement became noticeable among Norwegian banks. The main factors in this movement were the desire for expansion by the leading banks and the realization by the smaller banks of their insecure position in case of serious difficulties. The most prominent bank in this movement has been Den Norske Handelsbank, Oslo, which is now in process of liquidation. Although subsequent investigations have shown that the failure of this bank was largely due to losses incurred through the taking over of other banks, this should not be used as an argument against consolidation, as the losses were actually incurred before the consolidations, and would have led otherwise to the suspension of the individual banks at an earlier date. An example of successful consolidations may be found in Bergens Privatbank, one of the strongest financial institutions in the country.

In several cases the optimism during the war led to the establishment of a number of superfluous banks in the smaller cities. In 1922 and 1923, during the depression, many of these new-established institutions were merged with the older and larger commercial banks.

SAVINGS BANKS

History. The first savings bank to be established in Norway was the Christiania Sparebank in 1822; then followed in 1823 the Bergens Sparebank, the Trondhjems Sparebank, and the Drammens Sparebank.

From a modest beginning savings banking in the country has

grown rapidly, so that there is now a savings bank in practically all towns and municipalities. In 1850 there were 90 savings banks in the country; in 1900 this figure had grown to 413, in 1910 to 487, and in 1923 there was a total of 579 savings banks with aggregate deposits in excess of 2,500 million kroner. From the beginning savings banks have thrived in Norway, and the widespread habit of keeping savings accounts has become a national characteristic, which developed as the country grew in importance. The greater part of the savings funds are invested in loans against bonds and mortgages and in direct loans to savings depositors. The competition between savings banks and private banks has been very active. The most popular form of deposits, "on savings bank terms" and "on six months' notice" are solicited just as eagerly by the private banks as by the savings banks.

The mutual savings banks of the country have established a central institution in Oslo, Fellesbanken A/S, to take care of transfers in accounts and of remittances abroad.

Security Fund. In order to put the savings banks on a safer basis and to provide for joint security in case of emergency and difficulties among one or more of them, the Security Fund for Savings Banks was established by the law of July 4, 1924. The fund is the joint property of the savings banks. Its purpose is to assist savings banks, which have encountered difficulties, but which are considered solvent and whose existence is warranted. The assistance will be made in the form of loans or deposits on reasonable and, as far as possible, safe terms.

The administration of the fund is closely associated with the Savings Bank Inspection. The surplus funds are invested preferably in government securities and bonds issued by the semi-governmental institutions such as the Mortgage Bank, the Farmers' Bank, the Fishery Bank, etc.

INVESTMENT BANKS

The general public in Norway has not been inclined to employ their surplus funds for investments in stocks and bonds. Such funds have generally been deposited in savings accounts, and the

banks thus became the investing middlemen. Without an active market in stocks and bonds through which to make flotations of shares and debentures, the banks naturally were called upon to carry the burden of the fixed-capital requirement of trade and industry, without the support of any direct investment demand from the general public.

The investment banks in Norway are therefore of no great importance, and during the crisis in 1922–23 the majority had to liquidate. Some of the most important ones are listed below:

Nordisk Bankinstitut, Oslo, was established in 1917 with a capital of Kr. 8,000,000. Difficulties were encountered in 1922 and operations were discontinued in 1923. The entire capital stock was lost.

Norsk Emissionsinstitut, Oslo, was established in 1918 with a capital of Kr. 6,000,000, of which only 50 per cent was paid up. This institution was closely affiliated with Den Norske Handelsbank, Oslo, and like the latter institution, it is now being liquidated.

A/S Norsk Investment, Oslo, was established in 1917 with a capital of Kr. 15,000,000, fully paid. It was absorbed by Andresens og Bergens Kreditbank (Foreningsbanken) in September, 1921.

Norsk Oversjöisk Bank Union A/S, Oslo, was established in July, 1918, with a capital of Kr. 5,000,000, which was increased in 1919 to Kr. 15,000,000. It was formed as a holding company and owned a majority of shares in Banco Escandinavo Argentino, Buenos Aires, and Banco Escandinavo Brasileiro, Rio de Janeiro. Plans for establishment of Norwegian banks in China did not materialize. The bank in Rio de Janeiro was liquidated in March, 1925, and the bank in Buenos Aires, although still operating, has not shown satisfactory progress. Also this investment bank had to liquidate in 1925 without any dividend to the stockholders.

The other investment and finance institutions in Norway are comparatively small and limited and most of them have shared the similar fate of the larger ones.

The wave of private speculation during the war period greatly increased the demand for industrial, shipping, mining and other stocks, but even so, this increased demand for stock from individual investors did not keep pace with the demand for fixed

capital from enterprises booming under the impetus of war demands and profits. Practically all the fair-sized banks established securities departments, which during the boom furnished a large part of the earnings of the banks. Being so closely tied up with various industries, the banks frequently had to make loans to their customers against collateral of stocks in the selfsame enterprises as were sponsored by the banks. This additional load cumulated until the time of the trade depression and rapidly falling values, when there occurred slumps in the market quotations of stocks in affected enterprises. It then became apparent that the banks would have to stand punishment in their dual rôle of supporting sick industries and the enforced carrying of loans to individuals secured by shares for which there remained no market except that provided by the banks themselves.

FIDUCIARY FUNCTIONS

The fiduciary functions of Norwegian banks are almost negligible. The general public does not seem to have realized the advantages a bank can offer as individual or corporate trustee. Although some of the larger banks have established trust departments, it seems that the recent banking crisis has so severely shaken the confidence of the public in banks in general, that the development of this particular field is temporarily at a standstill. This fact explains also the absence of institutions similar to the American trust companies.

AGRICULTURAL CREDIT BANKS

There are only three large agricultural credit banks in the country, all semi-governmental institutions. The most important one is the " Kongeriket Norges Hypothekbank " (The Mortgage Bank of the Kingdom of Norway), with its head office in Oslo and branches in Bergen, Trondhjem, and Tromsö. It was established by law of September 18, 1851, and began operations in 1852. Its purpose is to " enable property owners to obtain loans on their properties." The bank's original fund was supplied by the Gov-

ernment and cannot be reclaimed until the bank has been liquidated and its obligations to the creditors paid. On this fund the bank pays four per cent interest to the Government and the remainder of the profits is added to the original fund. In order to provide additional funds the bank may issue bearer bonds up to an amount not exceeding eight times the amount of the original fund. Loans may be granted on first mortgages only. At the end of 1919 the original fund amounted to Kr. 32,000,000 and bonds outstanding to approximately Kr. 251,000,000.

Another bank of a similar type was established in 1903 for the purpose of encouraging the development of smaller farms and the ownership of homes. Its Norwegian name is "Den Norske Arbeiderbruk- og Boligbank" and its Board of Directors is identical with that of the Mortgage Bank. It has a capital of Kr. 7,200,000 and bonds outstanding to the amount of approximately 32 million kroner. It discontinued granting loans on December 31, 1916, and there was substituted the "Den Norske Stats Smaabruk-og Boligbank," which began operations on January 1, 1917. The funds for both these banks were obtained from the Government and the loans are granted with or without municipal guaranty. The latter also offers an opportunity to the municipalities to obtain loans for the purchase of certain areas to be subdivided into smaller farms and for the construction of municipal dwellings.

CONCLUSIONS

The Norwegian banks were severely hit by the post-war crisis, which appeared in 1920, and although there was but one bank failure then, subsequent studies revealed that 1920 was really the critical year. In 1921 and 1922 several banks had to be reconstructed by the aid of Norges Bank and the large private banks. The climax in the Norwegian bank difficulties was reached early in 1923. When the Bank Administration Law was passed on March 24, 1923, its principal purpose was to protect solvent banks against runs. It intended to give the banks an opportunity to liquidate their engagements in peace and gather the reserves necessary to meet the demands of the depositors and to regain their confidence. Its aim was praiseworthy, but it did not suc-

ceed as intended, as most of the banks soon proved to be in a state of hopeless insolvency. Thorough reconstructions have been attempted; these have in most cases been without success. Only two banks have hitherto succeeded in being reconstructed, viz., Aalesunds Kreditbank, Aalesund, and Skudesnes Privatbank, Skudesnes. The two largest banks which were placed under public administration, viz., Centralbanken for Norge, Oslo, and Andresens og Bergens Kreditbank, will be reconstructed, and the latter will probably again be separated into Andresens Bank, Oslo, and Bergens Kreditbank, Bergen, as before the amalgamation in 1921. Besides the banks mentioned above there are only 2 or 3 banks which are expected to be able to pay depositors and creditors 100%; most of the others have already started to liquidate or will begin to do so in the near future.

At the present time there are about 70 banks in Norway which are under public administration or in the process of liquidation. This figure includes three of the largest banks of the country, of which one, Den Norske Handelsbank, is now being liquidated. It still remains to be seen how many banks will ultimately be liquidated. Several are expected to pay a dividend of only 10%–20% to the depositors, and the capital stock and reserves must be considered entirely lost in practically all. The Norges Bank has come to exercise an administrative power and control previously unknown. At the very beginning of the Norwegian banking crisis, it had to lend a helping hand to the banks in distress, and this activity of the Bank increased as the condition of banks grew worse. It was naturally to be expected that certain losses would be sustained on such advances; but from another point of view this attitude of the Norges Bank probably prevented a national calamity which might have shaken the entire economic foundation of the country.

It seems that Norway has now passed the critical point as far as banking is concerned. Several new banks have been established on a sound economic basis and the reconstruction of some of the other banks shows good progress. The three large banks which did not encounter any serious difficulties during the crisis, i.e., Christiania Bank og Kreditkasse, Oslo, Bergens Privatbank, Bergen, and Den Norske Creditbank, Oslo, have become stronger than ever. The Norges Bank continues to hold a dominant posi-

tion in the country's banking, as it is practically controlling all the banks now under public administration.

The outstanding feature of the present banking situation in Norway is the large amount of deposits of the banks which were least affected by the crisis. In the case of several the situation has become quite embarrassing and they have been obliged to refuse some on account of the negligible demand for advances from the depressed trade and industry.

Mainly as a result of the new banking law and its broad powers to the bank inspection office, a decided improvement in Norwegian banking practice has taken place. The bank inspectors have full authority to make investigations, to demand statements, and to call meetings of the board of directors, and through these activities sounder banking principles have been introduced.

CHAPTER XIII

THE BANKING SYSTEM OF RUSSIA

BY

S. S. Katzenellenbaum [1]

A BRIEF SURVEY OF CURRENCY IN RUSSIA

Chief Phases in the History of Currency in Russia. The history of currency in Russia since the middle of the 16th century is, broadly speaking, a history of the " debasement of the coinage " for fiscal ends, that is to say, utilization of the coinage for replenishing the financial resources of the State. Debasement itself, i.e., abuse of the coinage for the purpose of gain, generally speaking began as a practice even earlier, and by the 16th century Russia was familiar both with the practice of tampering with the coins and with popular rebellions on account of this. Until the 16th century, however, the business of coining money in Russia was in private hands, and all the gains from the debasement of the coins were reaped by the " denejniki " and " livzi " (private money-makers), or rather by the capitalists who financed them and to whom the metal belonged. The first State Mint, " Denejni Dvor," was established in old Muscovy in 1535, when the business of coining money was taken over by the State, which began to exploit this resource for its own ends.

Demand for Money Arose from Incessant Warfare. The fact that the coinage was constantly used in Russia as a means for deriving income should not be a matter for surprise, taking into consideration that the abuse of the coinage on the part of the State, as is corroborated by historical study, was generally forced upon the government and invariably indulged in during wars and revolutions. As for that, the history of Russia for the last three and a half centuries is a history of intermittent wars. The terri-

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torial expansion of this country, the transformation of the small Kingdom of Moscow, which was until the end of the 15th century under the heel of the Tartars, into present-day Russia, occupying one-sixth of the earth's globe, was achieved at the cost of uninterrupted fighting. Neither could Russia boast of "social peace" during that period. Wars alternated with rebellions and revolutions, with which the 17th and 18th centuries (the so-called "Smuta" riots of 1610–1613, the revolt of Stepan Razin, and Pugachev) and the beginning of the 20th century were especially replete. All this created a constant need for money and induced the governments of Russia to make use of the "ultima ratio" of financial resources, coinage.

Debasement of the Coinage. While pointing out that the debasement of coinage left its mark on the whole history of currency in Russia for the last three centuries, it should be emphasized, however, that this does not in any way signify that the government derived profits from this source continuously from year to year. The public, as is known, is apt only for a certain time not to perceive changes in the monetary circulation and to allow the fisc to profit. When the practice of debasement of the coin reaches a certain limit, the governments indulging therein are usually obliged to desist and take measures for the reconstruction of the currency. This is what constantly took place in Russia. Following more or less prolonged periods of debasement, reforms of the currency were undertaken, but the currency was not stabilized long before the governments resorted again to its exploitation as a fiscal resource, which was usually the case at the commencement of a new war. The history of currency in Russia therefore abounds in "monetary reforms." The monetary circulation thus went through a kind of cyclic evolution: periods of acute disturbance, periods of more "chronic" disturbance, periods, usually short-lived, of a certain measure of stabilization, and so on.

If we enter into a closer examination of the means by which the currency was used in Russia for fiscal purposes we should first of all note that, broadly speaking, the monetary policy of the country during the 16th–20th centuries passed through three stages in this connection: (1) the first period from 1535, from the moment of the establishment in Moscow of the State Mint and

the concentration of coinage in the hands of the State, down to the middle of the 17th century, or to be more exact until 1656, during which period tampering with the coins went on in the form of reducing the metallic content of the *silver rouble;* (2) the second period, embracing about a century from the middle of the 17th century until the sixties of the 18th century, i.e., until 1769, when the debasement of coinage took the form principally of the issue of *copper money,* although the reduction of the value of the silver coins was still being practiced; and finally, (3) the third period, from 1769 to our times, when the chief resource for filling the treasury at times of financial stress is represented by *paper money.*

Paper Money in Russia. Without dwelling on the first two remoter periods of Russian currency, we shall give some information in regard to the history of paper money in Russia.

Paper money, as we have said, first appeared in Russia in 1769 in the reign of Catherine II. From that time in fact paper predominated in the monetary circulation of Russia, metal appearing only on two or three occasions for a comparatively short time. The century and a half during which paper money has been current in Russia is divided, however, into a few periods, among which are periods of " sharp " paper-money inflation and periods of " chronic " circulation of paper money. Taking the sharp processes of paper money inflation, we get, generally speaking, four periods of paper currency in Russia: (1) the period of the circulation of assignats at the end of the 18th and the first third of the 19th centuries; (2) the period of the issues of inconvertible credit notes during the Crimean War in 1853–1857; (3) the period of the issues during the Russo-Turkish War in 1877–1879; and (4) the new period of paper currency in 1914–1923.

Assignats. The *first* period commenced with the issue of assignats in 1769. In accordance with the Manifesto of December 29, 1768, there were established two State banks " for exchanging assignats," one in Petersburg and the other in Moscow. At first the issue amounted to not more than one million roubles and the two banks were provided with 500,000 roubles worth each of copper money. At that time (up to 1786) the assignats were still convertible. The Government shortly commenced to effect fresh issues of assignats, this time not merely for facilitating trade and

for " the convenience of the public," but for covering its special expenses. In 1786 the amount of assignats issued reached 50 million roubles. The new war with Turkey which was just beginning impelled the government of Catherine II to increase the issues of assignats. In accordance with the scheme of Count Shuvaloff this issue was to have brought the total amount of assignats up to 100,000,000 roubles. At the same time the Petersburg and Moscow banks were transformed into a single State Bank of Assignats. By the year 1796, at the time of Catherine's death, the amount of assignats in circulation reached 157.7 million roubles. Subsequently the amount of assignats in circulation continued to grow and in 1817 reached the figure of 836 roubles.

Owing to the extensive issues of assignats a shortage soon appeared in the metallic reserves, so that about 1786 the government was compelled to suspend payment, this being done without the publication of a special act. The results of the transition to a paper currency and the issue of assignats soon became evident. The assignats began to fall on the international money market and the government of Catherine II was compelled to have recourse to measures of foreign exchange policy. Simultaneously, the assignat rouble in terms of commodities began to depreciate; in other words, commodity prices began to rise.

" FINANCE SCHEME " OF SPERANSKY. This state of affairs naturally evoked an attempt to set the currency right. The first serious measures in this connection are associated with the name of State Secretary, Speransky. In 1810 he drew up, in conjunction with prominent functionaries of the time, a " Finance Scheme " which was to have been carried out in the course of a number of years and restore the national economy of Russia. In the sphere of currency the " scheme " prescribed the abrogation of the assignats, curtailment of the copper coinage by converting it into exchange money, and the establishment of a bank which would issue notes convertible into silver. The foreign complications which very soon set in stopped these schemes. Not only was the amount of assignats not reduced, but it had to be increased to finance the war with Napoleon. The " schemes " had to be abandoned, and Speransky himself, as a result of intrigues, lost his position and was exiled to Perm. The manifesto of April 9, 1812,

issued very soon after the disgrace of Speransky, laid down entirely different principles to those marked out in the " Finance Scheme ": the assignats were recognized as the proper legal tender, their circulation was made obligatory, and they were declared the basis of all accounts and payments; in other words, they were made the chief currency of the country. This law, however, at the same time allowed the circulation of silver coins, the concluding of contracts in this coin, and the acceptance of payment at the *rate of exchange* of paper to silver.

We have seen that in 1817 the amount of assignats in circulation reached the highest figure of 836 million roubles (according to data as to the end of the year). The subsequent history of the assignats is divided into two periods: during 1818–1823 fruitless attempts were made to raise their value by reducing their volume; and from 1823 (the ministry of Kankrine) preparations for devaluation were commenced which finished in 1843.

Currency Reform of 1839–1843. *The reform of 1839–1843* which put an end to the circulation of assignats *by means of devaluation,* a reform associated with the name of the Minister of Finance, Kankrine, was initiated by the manifesto of July 1, 1839. This manifesto established that henceforth the silver rouble was to be the monetary unit. The assignats " remain an auxiliary token of value " with a " fixed and unvarying rate of exchange against silver " of 3 roubles 50 copecks per 1 rouble silver. (Cl.2). This reform was consummated by the manifesto of June 1, 1843. That manifesto ordered the issue of credit notes exchangeable for silver and prescribed the replacement of the assignats by these notes at the old fixed rate of Roubles, 3.50 assignats for 1 rouble in credit notes. This exchange of assignats into credit notes continued until 1852, and by 1853 there did not remain any assignats in circulation. *Credit notes* to an amount of 170.2 million roubles were issued in place of the 595.8 million roubles *assignat circulation* and henceforth Russian paper currency retained this denomination of " Credit Notes " (Kreditnie Billeti). The metallic reserve serving as security for the exchange of these notes comprised, in 1843, 28.5 million roubles.

The relative stability in the field of currency was short-lived, and came to an end in 1853. In the course of these ten years the government rigidly adhered to the law governing the credit note

issue and its cover; the credit notes freely circulated in the country side by side with silver coin, and the bill of exchange rates deflected little from parity. All this, however, came to an end in 1853 when the Crimean War broke out and the government of Nicholas I in 1855 started to effect " temporary issues " of credit notes specially for war needs. In 1855 credit notes were issued for a sum of 215.1 million roubles, in 1856 to a sum of 153.3 million roubles and, in 1857, 74.1 million roubles. The total circulation of credit notes at that period comprised: at the end of 1853, 333.4 million; 1854, 356.3 million; 1855, 509.1 million; 1856, 689.2 million; and 1857, 735.2 million roubles. In other words, the volume of credit notes from 1853 to 1857 expanded by 136%. Under these conditions the redemption of credit notes could not continue, and at first it was embarrassed and eventually in 1856 entirely stopped.

Russia entered upon the second stage of a *sharp* paper money process, a period which was accompanied by the usual features peculiar to this phenomenon. On the one hand the exchange rate of the rouble abroad deflected from parity and lost its stability, while on the other commodity prices on the home market began to rise. A few years after the end of the war, in 1862–1863, an attempt was made to restore the exchange of credit notes into silver and to return to the system of monetary circulation which existed before 1853, but this ended in failure.

The country became immersed in a protracted period of " chronic " paper circulation, which continued right up to 1897. Only the period 1877–1879, during the war with Turkey, saw another sharp outbreak, which is what in fact we regard as the *third period* of paper-money inflation. It should be said that national economy in the eighties and nineties of the 19th century did not experience such violent shocks from the currency as in the periods aforementioned. In the course of all this time, however, the rate of the Russian currency abroad was subject to strong fluctuations, and this perceptibly hindered the development of Russia's foreign trade. That is why both decades witnessed an intensive activity concerned with the preparation of a currency reform, in the direction of restoring the metallic circulation. At this time, however, important developments took place, as is known, in the currency of the European countries when gold

began to displace silver as the metallic standard in many countries. Russia was bound to reckon with this fact, and *had to adopt the gold exchange rouble through the inconvertible credit notes in place of the silver exchange rouble.* This peculiar evolution left its mark on both the economic and legal aspects of the reform carried out in 1897 by the Minister of Finance Vitte.

THE REFORM OF 1897. The principal features of this reform were as follows. First of all, before making the transition to the new currency it was essential to *accumulate a metallic reserve.* The accumulation of gold which was afterwards to serve as a fund for the exchange of credit notes was commenced in earnest under the Minister of Finance Bunge (1881–1887) and continued under Vishnegradsky (1887–1893) and Vitte (from 1893). The accumulation of a metallic exchange fund by the State Bank, which was then a bank issuing credit notes, was effected by way of the treasury delivering to it gold " in repayment of the debt." The treasury received gold from various sources: revenue from customs duties, which since the seventies were collected in gold, various other tax receipts of the treasury, purchases of gold on the open market, the realization on internal and foreign markets of special " gold " loans — all of which gold was gradually turned over to the exchange fund. By means of these transfers, which continued up to the year 1900, the exchange fund was brought at that time up to 1,068 million roubles and fully corresponded with the note circulation. The currency reform, in this respect, cost the State very dear. In the course of two decades, on the whole, about three-fourths of a milliard roubles of State funds were spent on the purchase of yellow metal. Such expenditures were certainly a great strain on the Russian budget of the nineties. Yet it should be observed that the very possibility of such disbursements being made was due to the comparatively favorable state of Russian finances in that period.

STABILIZATION OF THE EXCHANGES. Other measures which were taken in connection with the preparation of the reform consisted in *stabilizing* the exchange. One of the measures adopted to mitigate the fluctuations of the rouble rate was, first of all, the *intervention* of the Russian Ministry of Finance, i.e., it came out on the international money market as a buyer and seller of Rus-

sian credit notes. It should be remarked here that this intervention in some periods was more concerned with preventing the rise rather than the fall of the rouble rate. The rise in the rate was unprofitable for the landowners as the exporters of grain and the Ministry of Finance endeavored to protect their interests against this annoyance. In addition to intervention on the speculative market another important measure, which had the same results, was permission to receive gold in payment of State taxes *at the fixed rate* of gold coin to credit notes.

Circulation of Gold. Among other measures aiming at the transition to the new currency an important place was occupied by those which were designed to *gradually introduce gold in the public circulation.* Besides these there were other noteworthy measures, such as *licensing of contracts in gold,* the issue of *metal deposit certificates* made acceptable by the treasury and the State Bank similar to specie, and finally the State Bank from 1895 began freely to " buy and sell " gold coins at the fixed rate. This really signified the actual resumption of the credit note redemption.

The above measures did, in fact, signal the transition to a gold standard. The laws which were passed during 1896–1897 merely legalized the already accomplished reform.

Thus ended at the close of the 19th century the epoch of paper currency in Russia. This time the reform proved to be successful, at least in so far as the exchange went on unceasingly and gold coin circulated on equal lines with credit notes. The amount of money in circulation began to rise steadily, and along with it increased the gold reserves of the State Bank. At the same time the rate of the Russian rouble abroad was definitely stabilized. The Russian money market established close ties with the international money market. The fears expressed by the opponents of the reform that the gold would begin to trickle out of the country, etc., were not realized. The gold currency survived without any serious shocks the war with Japan and even the revolution of 1905–1906. The year 1914, however, saw the end of " the happy days " of the gold currency, and Russia entered upon a new, this time the fourth, epoch of paper currency. This epoch was destined to break many records and assume the most unprecedented forms.

The Decline of Russian Currency in 1914–1922.[2] Immediately after the declaration of war the Russian Government enacted a law which brought about fundamental changes in the structure of the country's currency. This was the law of July 27 (August 9, New Style) 1914, providing for: *first,* the suspension of gold payments for bank notes; *second,* the granting to the State Bank of the right to issue bank notes unbacked by gold to the amount of 1.2 milliard roubles over and above the amount which it may have issued previously (before that law the State Bank, with a gold stock exceeding $1\frac{1}{2}$ milliard roubles could put into circulation unsecured bank notes to an amount of 300 million roubles). In addition the same law gave the State Treasury the power to discount its short-term obligations at the State Bank "to the extent called for by the exigencies of the war period."

By introducing an inconvertible bank note in Russia the law of July 27, 1914, was the first step in the direction of increasing the amount of monetary tokens. The war demanded great expenditure and in Russia, as in other countries, the printing press became the chief instrument by which these emergency expenses were to be met. But Russia was unable to renounce this kind of revenue even after the war had ceased. The war passed into revolution. But revolution, like war, is a cause for extraordinary State expenditure and occasions the issue of paper money. Thus the need for paper money did not disappear in Russia. On the contrary, after the revolution of February, 1917, it became even more urgent. There set in a general decline in production and a general falling off in national labor. The Provisional Government tried to stave off the fresh disasters by the issue of paper money. The printing press began also to work for the revolution. The employment of paper-money resources, as we shall see later, became even more intense after the October revolution. The printing press, released from financing the World War, was taken by the Soviet Government into its service and requisitioned to finance the coming expenses of civil war and social undertakings.

Three Periods in Issuance of Paper Money. From the be-

[2] For more detailed information on this period see the author's book "Russian Currency and Banking, 1914–1924" (P. S. King & Son, London, 1925) Ch. III.

ginning of the World War down to the time when the old rouble was finally liquidated, there were *three* distinct periods in the issues of paper money which correspond with the periods of different political régimes. The first is from the beginning of July, 1914, to the February revolution of 1917, when paper money was issued exclusively for financing the war; the second, the period of the Provisional Government from the February revolution, 1917, to the October revolution, 1917, when both the war and the revolution were being financed by paper money; and the period after October, 1917, when paper money began to serve as a means of covering the deficit of the Soviet Government.

After the Law of July 27, 1914, the State Bank was empowered by the old government to issue credit notes unbacked by gold on four occasions (Laws of March 17, 1915, August 22, 1915, August 29, 1916, and December 27, 1916) and at the time of the February revolution the State Bank thus had the right to issue credit notes unbacked by gold up to 6½ milliard roubles.

The Provisional Government extended the issuing rights of the State Bank on five occasions, the last time on October 6, 1917, making a total of 16½ milliard roubles. Under the Soviet Government credit notes were issued for a long time without any special law. But by Decree of October 26, 1918, it was enacted:—

> "For the purpose of regulating the issuing operations of the People's Bank (the former State Bank) the power of issuing credit notes given to this bank is to be increased by 33,500 milliard roubles, including in this sum all the credit notes issued by the Bank over and above the limits of the issuing rights established by previous legislation."

Thus, taken as a whole, the fiduciary issue rights of the State Bank by the end of October, 1918, had been increased to 50 milliard roubles. After this, however, issues of paper money went on without an extension of the issuing rights. The process of extension of issuing rights later lost its significance, when at the beginning of 1920 the State Bank was liquidated and the issue of paper currency was effected through the "Department of Monetary and Account Tokens."

Disappearance of Metallic Money. Before the war, Russian currency consisted in general of credit notes, gold, token silver and copper coinage. The total volume of money circulating in the country at the beginning of 1914 may be estimated at about 2 milliard roubles. Immediately after the declaration of war, metallic money began to disappear from circulation. This disappearance occurred gradually. First of all the gold coin disappeared. After some months, fine silver began to disappear from circulation; the roubles, half-roubles, and quarters. In the summer of 1915 a shortage was felt in small silver and copper money and at the beginning of 1916 Russian currency consisted exclusively of various kinds of paper. The volume of paper money circulation, moreover, registered a marked increase.

Increase in Paper Money Issues. As is to be seen from the following table paper money was issued in the following amounts:

In 1914	1,317	million roubles, an increase of	80.8%
1915	2,670	" " " " "	90.6
1916	3,480	" " " " "	62.0
1917	18,203	" " " " "	200.1
1918	33,500	" " " " "	122.7
1919	164,200	" " " " "	270.1
1920	943,600	" " " " "	419.3
1921	16,375,300	" " " " "	1,400.0
1922	1,977,000,000	" " " " "	11,300.0

The chief consequence of the issue of paper currency is invariably the depreciation of money in two directions: a fall in the purchasing power in relation to commodities, and a fall in the exchange rate. Both these phenomena took place in the course of 1914–24 in Russia, and both the one and the other depreciation reached enormous dimensions.[3]

Fluctuations in Prices. To characterize the first of these two processes mentioned above, that is to say, the fall in the purchasing power of the paper rouble, we shall use the figures of the average prices of goods (indices) of the Gosplan, the State Planning Commission of the Council of Labor and Defense, for 1914–23 for the whole of Russia.

[3] We must, however, bear in mind that the process of depreciation of Russian money strictly speaking only went on until the end of 1922. During 1923, when Russia had two valutas — the Chervonetz and the Soviet rouble — only the second continued to depreciate rapidly.

From these figures we can see that the general index of commodities for the whole of Russia increased each year as follows:

1914	by	28.7%	with	an	increase	of	issue	of	80.0%
1915	"	20.0	"	"	"	"	"	"	90.6
1916	"	93.5	"	"	"	"	"	"	62.0
1917	"	683.3	"	"	"	"	"	"	200.1
1918	"	597.5	"	"	"	"	"	"	122.7
1919	"	1,375.6	"	"	"	"	"	"	270.1
1920	"	594.2	"	"	"	"	"	"	419.3
1921	"	1,614.3	"	"	"	"	"	"	1,400.0
1922	"	7,196.9	"	"	"	"	"	"	11,300.0

Comparing the growth of the index number with the increase of the volume of paper money, the fact is revealed that there is no concurrence between the rise in prices and the increase of issue. The velocity of issue and of depreciation do not once coincide over the nine-year period. By examining these two series of figures more carefully we discover further the fact that from a given moment the rate of depreciation of the paper money unit begins violently to outstrip the rate of issue. With the successive issues the depreciation of paper money does not increase commensurably with the increase in volume, but much more than that. Thus, in 1917 the volume of money increased, for instance, by $2\frac{3}{4}$ times, and the rouble depreciated 8 times. In 1918 the volume of money increased $2\frac{1}{4}$ times and the rouble fell 7 times. In 1919 the volume of money increased 4 times and the rouble depreciated 15 times. In 1920 the volume increased 5 times and the rouble depreciated 7 times. In 1921 the volume increased 15 times and the rouble fell 17 times. The breaking point of this process set in in 1916. During 1914–15 we see the opposite going on. Prices increase more slowly than the amount of money in circulation.

Fall in the Exchanges. Parallel with the depreciation of the paper rouble in relation to goods there was also a depreciation in relation to gold and to foreign currency, or a fall in the exchange rate. We will not dwell here on the details of this. It is only interesting to note that in October, 1920, the gold rouble was worth 3,500 paper roubles at an index number of commodities of 12,400, and the internal depreciation exeeded the external by $3\frac{1}{2}$ times. During 1921 the relations gradually changed. The fall in the exchange caught up with the fall in the purchasing power of

the rouble. At the end of 1921 the two processes had nearly reached a level. On January 1, 1922, with the index number of commodities at 244,000 the rate of the gold rouble had reached 150,000. The rate of the £ sterling in Moscow at that time reached 1,250,000 roubles and came very near to the theoretical parity.

A Shortage of Money. From a certain point in 1916 as we have seen above, the rate of depreciation of the paper rouble began to exceed the rate of issue. One of the consequences of this phenomenon was the gradual diminution in value of the total volume of paper currency in circulation and — in consequence of this — a shortage of money in circulation. According to approximate calculations the purchasing power of the total volume of paper money in circulation varied as follows in millions of roubles: January 1, 1914 — 2000; January 1, 1915 — 2500; January 1, 1916 — 3800; January 1, 1917, 3100; January 1, 1918 — 1100; January 1, 1919 — 379; January 1, 1920 — 93; January 1, 1921 — 70; January 1, 1922 — 61; January 1, 1923 — 95. From 1920 the total value of paper money in circulation was about 70 to 100 million roubles. At times (as happened in May, 1922) the value fell to the equivalent of 35 to 40 million pre-war roubles; or, in other words, *the value of the volume of paper money was then fifty times less than the value of the volume of money in circulation in 1914.* Simultaneously with the reduction in value of the total volume of money, there occurred also — at the time of the revolution — a decrease in the value of trade in commodities; crops and the producing capacity of industries decreased, etc. Nevertheless, the decrease in " commodities " was not so considerable. The quantity of money was therefore insufficient and both trade and the monetary circulation were affected by a " money shortage." Another consequence of the disturbance of the currency system was revealed in this fact.

Currency Reform. The disorganization of the currency which was at its highest in 1922, was liquidated by the reëstablishment of the currency in the following years. The reëstablishment of the currency system by the Soviet Government passed through two stages. The first was the issue of bank notes, "chervonetz," by the State Bank of the R.S.F.S.R. (later of the U.S. S.R.) which began at the end of 1922; and the second, the final

liquidation of the Soviet rouble and the issue of a stable Treasury note, in February–May, 1924. We will deal with these measures in connection with the operations of the State Bank later on.

RUSSIAN BANKS BEFORE 1917

Two Periods in the History of Russian Banking. One of the first measures of the Soviet Government after the October Revolution of 1917 was the nationalization of the banks which was carried out on the strength of various enactments, of which the chief was the decree of December 14,[4] 1917. The nationalization of the banks, owing to the civil war which commenced soon afterwards and a number of other changes in the economic field, resulted in the old banks being virtually liquidated by 1919–1920. During 1920–1921 there were, generally speaking, no credit institutions existing in Soviet Russia. Eventually, owing to the change in the economic policy of the Soviet Government and the adoption of the principles of the so-called " new economic policy," it was deemed necessary to reëstablish the banks. The reëstablishment of the credit system commenced at the end of 1921 with the inauguration of the State Bank of the R.S.F.S.R. (afterwards renamed State Bank of the U.S.S.R.), after which certain other credit institutions also sprang up. By 1928 the U.S.S.R. had a number of the types of banks which existed in the country before the revolution and some banks of a new type; the business of these banks reached very large dimensions and began rapidly to catch up with that of the pre-war Russian banks. In the sphere of banking Russia thus experienced in 1918–1928 the same evolution which it underwent generally in the sphere of national economy — namely, a sharp decline in the course of 1918–1921 and subsequently an impetuous recovery in the course of 1922–1928. However, owing to the special nature of banking, the ties between the old banking system and the new one proved to be much more dissevered than in other spheres of business, as for instance, agriculture or industry. The new credit system which was inaugurated in Soviet Russia at the end of 1921 had no legal succession whatever to the old credit institutions, which had

[4] According to New Style, adopted in 1917–Dec. 27.

been liquidated completely, and did not inherit any part of their assets or liabilities. It was being built up entirely anew. This created a sharp break in the history of Russian banking, which can now be divided into two periods: the history of the old credit institutions which existed in Russia up to 1917 and the history of the new banks which were created after the revolution. We shall dwell in this chapter on the principal features in the activities of the banks in Russia before the revolution of 1917. The activities of the banks in the U.S.S.R. at the present time will be described in the last section.

Chief Types of Banks in Russia before 1917. Before 1917 there existed in Russia a ramified network of credit institutions of different types. On January 1, 1914, there were over 3,500 credit institutions, banks and their branches, besides the institutions of small credit. Generally speaking, all the old credit institutions of Russia may, by their nature, be divided into the following six chief categories:

1. *The State Bank,* the sole bank of issue in the country, being at the same time the central institution of credit and the bank of the Treasury.
2. *Banks of short-term commercial credit,* among which the chief place was occupied by the joint-stock commercial banks, the city public banks and the societies of mutual credit.
3. *Banks of long-term mortgage credit,* among which the chief were the two State mortgage banks — the State Nobles' Land Bank (Gosudarstvenny Dvoriansky Zemelny Bank) and the Peasant Land Bank (Krestiansky Pozemelny Bank), ten private joint-stock land banks and municipal credit institutions.
4. *Institutions of small credit.*
5. *Town Lombards.*
6. *Savings banks.*

Let us deal with the chief of these types of credit institutions.

The State Bank. The State Bank (old one) was founded in 1860 on the eve of the abolition of feudal rights in Russia, being reorganized from the former State Commercial Bank. The newly established State Bank, which commenced operation in July,

1860, was authorized to perform the following operations: "(a) buy and sell gold and silver, (b) discount bills of exchange and other term paper, (c) receive payments on bills of exchange and other term instruments for account of clients, (d) receive deposits: (1) for safe-custody, (2) on current account, and (3) for accrument of interest; (e) grant loans, and (f) negotiate State paper for account of clients and for its own account within the limits of its own resources."

Furthermore the State Bank took over from the State Note Printing Department the issue of Credit Notes (the paper money then in circulation).

Thus, the State Bank was established as a Bank of issue as well as a commercial bank.

The State Bank (old one) existed until 1917, when it was subjected to reorganization and soon afterwards liquidated in pursuance of the decree for the nationalization of banks. In the course of the State Bank's 57 years' existence great changes, as is known, took place in Russia's economic life. During that time an extensive network of railways had been built up, and industry had grown. Radical changes had also taken place in agriculture. Landowner enterprise steadily gave way to peasant farming. Peasant economy which had for a long time been chiefly concerned with grain farming gradually began to reorganize in the direction of an intensive cultivation of special cultures and cattle-breeding products. In short, Russia during this period from being a purely agrarian country became an agrarian-industrial country.

Activities of State Bank Affected by Economic Developments. Thus the activities of the State Bank in the course of this period were carried on under conditions which marked an important change in the economic life of the country. It should be borne in mind, however, that in the meantime certain other events had occurred which had their effect on the Central Bank. Russia during those years had been conducting three great wars: the war with Turkey in 1877–1878, the war with Japan in 1904–1905, and the war with Germany and her allies in 1914–1917, and had lived through three revolutions, those of 1905 and February and October, 1917. Furthermore, the country all this time experienced intermittent industrial crises. Great changes had oc-

curred also in the field of currency circulation. The outstanding facts in this respect were the inflation of 1877–1878, the transition to a gold standard in 1897, and the reversion to a paper currency at the beginning of the World War. Finally great changes, substantially affecting the State Bank's activities, took place in the credit system as a whole. In the first decades the State Bank continued to be the dominating factor on the money market. Later, however, private commercial banks began to arise: after the nineties they became serious competitors of the State Bank, which they gradually relegated to the position of " a bank of banks." Of some importance to the life of the Bank was the change in its statutes effected in 1894. The statutes of 1894 which were introduced in lieu of the old statutes of 1860 opened up for the Bank somewhat wider possibilities in the granting of credits to trade and industry.

All these occurrences could not but affect the trend of activities of the State Bank, which, while it reacted to the influence of all these changes, was at the same time itself a factor in the economic progress. Having existed for 57 years in an epoch replete with events, an epoch which, taken as a whole, may be regarded as one of industrial revolution in Russia, the State Bank naturally passed through various phases both in regard to its line of policy and, principally, in regard to its position on the money market.

I do not propose, however, to examine here at length the evolutions through which the State Bank passed during these years, but shall confine myself merely to a brief description of the development of its operations.

Changes in Functions of State Bank. A closer examination of the figures showing the movement of accounts of the State Bank for the period 1861–1917 first of all reveals that a material change took place in the direction of the Bank's activities at the close of the nineties, a change which allows the history of the State Bank to be divided into two sharply dissimilar periods. These data show that before the end of the last century the State Bank concentrated the main part of its activities in operations for regulating currency circulation and catering to the needs of the Treasury; it took only a small part in the financing of commercial transactions, and only in the course of the last 15–20

years of its existence did it become a more or less important factor in the sphere of credit.

This conclusion can be drawn from a comparison between two operations of the Bank: namely, the accumulation of a gold reserve and loan and discount operations. For the period 1861 to 1895 the bank's gold stock increased by 830 million roubles, from 82 to 912 millions, whereas loans and discounts for the same period increased only by 317 millions, from 46 to 363 million roubles.

If we divide the whole period under review into five-year periods and draw an average from the balance of funds employed in loan and discount operations for each five-year period (as per 1st January),) we get the following picture.

Loan and Discount Operations. The total amounts employed in loan and discount operations at the beginning of the year were on the average: (in millions of roubles.)

1861–1865	49.1	1891–1895	248.0
1866–1870	79.6	1896–1900	348.1
1871–1875	92.8	1901–1905	483.5
1876–1880	203.9	1906–1910	568.2
1881–1885	230.7	1911–1914	726.0
1886–1890	234.8		

As the above figures show in the course of the first period a more or less perceptible increase in loans and discounts took place only in the second half of the seventies when the average balance rose from 92.8 million roubles in 1871–1875 to 203.9 million roubles in the next five-year period. Following this, however, up to 1891–1895 the average balance of funds employed in loan and discount operations remained practically unchanged. A more or less steady growth of these operations begins from the next five-year period.

As we shall see further, a comparison between the loan and discount operations of the State Bank for these periods and the same operations of the private commercial banks does not suggest that the State Bank was of less significance in the money market in the eighties and nineties of the last century than during the last decades of its existence. Relatively, its rôle then was even greater. This, however, is accounted for by the fact that the private banks did not appear until as late as the sixties

and seventies and their operations in those years were as yet comparatively small.

The government was cognizant of the fact that loan and discount business was insufficiently developed. However, official sources were inclined to ascribe this fact to shortcomings in the bank's statutes. The true reason for the poor development of loan and discount operations of the State Bank was not however in a defect of the statutes. It is difficult to believe that the bank pursued this course for a period of 40 years only because it held " too narrow " a conception of the tasks for stimulating business with which it was entrusted as was alleged at meetings of the government committees. This sounds hardly plausible judging from the fact alone that the very inauguration of the State Bank, which was to have superseded the old Commercial Bank, was motivated by the necessity of creating a credit institution to cater to the needs of trade and industry. As a matter of fact, the poor development of the State Bank's loan and discount business was due not so much to deficiencies in its statutes as to more deep-lying causes. A mention of these causes is to be found in the work of Gurieff. " The State Bank," it says, " which according to the Statutes of 1860 had as its immediate aim the stimulation of commerce and the stabilization of the money and credit system, managed to fulfill this condition only to a small degree. The main hindrance to the State Bank's activities was the shortage of funds. A large part of the Bank's resources, which might have been used for stimulating commercial transactions, were expended in operations for account of the treasury, such as, for instance, the liquidation of debts of the old government credit institutions.[5] The same opinion is expressed by Migulin. " The State Bank," he says, " from the outset disposed of most insignificant resources for developing its commercial operations, as it was obliged to apply the bulk of its funds and the deposits of private clients in connection with the liquidation of the old credit institutions, and in supporting the private commercial banks whose bills the State Bank rediscounted. The Bank in the main served as a kind of branch of the Treasury for whose account it affected various disbursements." [6]

[5] *A. Gurieff.* " A Survey of the Progress of Credit Institutions in Russia." P. 1904 page 70–71 (in Russian).

[6] *P. Migulin.* " Our Banking Policy." Kharkov, 1904. P. 209 (in Russian).

Thus we are forced to the conclusion that the feeble development of the State Bank's loan and discount operations up to the close of the nineties was due chiefly to the fact that the Bank in the first decades of its existence was fettered by transactions connected with the regulation of the State debt and the preparation for a monetary reform. Only after 1897 when the currency reform had been completed and the position of the Treasury had consequently improved, did the Bank alter its policy and commence to engage more actively in commercial credit business. One can gather from the figures mentioned above that on a five-year average the State Bank had funds invested in loan and discount operations as follows: (figures for January 1st): in 1911–1914, 726 million roubles against 568.2 million roubles invested in these operations on the average for 1906–1910, and 438.5 million roubles for 1901–1905. Thus for a period of 10–15 years the loan and discount operations of the Bank increased on the average by 65.6%.

State Bank Becomes a Bankers' Bank. The accommodations which the State Bank afforded trade and industry for this period show a perceptible increase. At the same time the State Bank began more and more to assume the functions of a "Bank of Banks." This found expression in the fact that the State Bank invested a considerable portion of its funds through the medium of private banks, institutions of small credit, and others. In 1906–1909 the State Bank gave out to banks, institutions of small credit, and other credit intermediaries about 20–25% of funds which it had invested in loan and discount operations; in 1910–13 it already invested a half of its resources in this way, while only about a half were loaned out directly.

Importance of Treasury Deposits in State Bank. It is not proposed here to go into an examination of the various operations of the State Bank for the period under review. It is necessary however to point out that, according to the Bank's returns, *the chief source of funds on which the progress of the State Bank's asset operations in the course of 1895–1914 was based, was the resources supplied by the Treasury.* It suffices to quote by way of example the position of the bank's chief accounts on January 1, 1914. Under a total balance of 3040 million roubles the bank's assets included the following items:

Gold	1,695	million	roubles
Investments in loan and discount operations	1,072	"	"
Securities belonging to Bank	108	"	"
On accounts of Treasury	54	"	"
Other assets	50	"	"

against which, on the liability side, were:

Currency notes in circulation	1,665	"	"
Capital and funds	55	"	"
Funds of treasury (on a/c of Treasury Dept. and special funds and deposits)	951	"	"
A/C of savings banks	14	"	"
Other deposits and accounts	263	"	"
Other liabilities	93	"	"

Thus, the currency notes in circulation together with the bank's initial capital were almost entirely invested in the gold stock. The loan and discount operations, which exceeded in amount one milliard roubles, were carried on with funds received by way of deposits and current accounts. However, out of the total sum of 1,228 million roubles comprising deposits and current accounts 955 million roubles, or 81%, consisted of funds belonging to the treasury and the savings banks. The State Bank thus employed in its operations all the available reserves which at that time began to accumulate with the treasury, including the so-called "available cash" of the Treasury.

Effect of the War on State Bank. The war which broke out at the end of July, 1914, brought important changes in the direction of the State Bank's activities. We have had occasion to speak of this in connection with an examination of the changes which took place in the currency in 1914. It will be remembered that an important change took place in the operations of the State Bank in connection with the war. The State Bank during this period was converted into a chief center from which the war was financed; it discharged these functions by means of the issue of inconvertible notes which it passed over to the Treasury by way of discounting the short-term bills of the Exchequer. The State Bank acquired a new debtor in the person of the Treasury, which already by the end of June, 1915, owed to the bank twice as much money as all the other borrowers taken together. This debt of the Treasury's which in the bank's returns figured as discount of

the Exchequer's short-term bills, continued to grow during the years following; according to the last returns published before the October Revolution, i.e., on October 23, 1917, this item comprised 15.5 milliard roubles, while the aggregate amount of funds invested in loan and discount operations showed at the same date 19 milliard roubles. In other words, it exceeded other debts by 4 to 5 times. At the same time, as we shall see further, changes also took place in the relationship between the State Bank and the private banks.

Liquidation of State Bank. The October Revolution and the subsequent financial legislation of the Soviet Government brought various changes in the position of the State Bank. The Decree regarding the nationalization of banks approved by the Central Executive Committee on December 14, 1917, brought about the fusion of all private joint-stock banks and banking offices with the State Bank. The following two to three years saw the gradual liquidation of the State Bank. We shall dwell on this process of liquidation in the next chapter when dealing with the history of private banks. Here however we shall merely point out that the State Bank renamed the People's Bank (Narodny Bank) existed in the shape of a bank for about another two years and was abolished in January, 1920, when what remained of it was turned over to the new Budgetary and Accounting Department formed under the People's Commissariat of Finance.

Joint-Stock Banks. Among the institutions of short-term credit the joint-stock commercial banks were, with the State Bank, the most important factors on the money market in Russia. The joint-stock commercial banks, which, as a type of credit institution, resembled the English " joint-stock banks " or the German " Depositenbanken," began to spring up in Russia comparatively late, i.e., only after the abolition of serfdom.

The first joint-stock commercial bank — the St. Petersburg Private Commercial Bank — came into being in 1864, and the government took part in the formation of its capital stock. In 1866 was established the first joint-stock commercial bank in Moscow — the Moscow Merchants' Bank. Two more banks were founded subsequently in the same year; the Kharkov Trading Bank and the Kiev Private Commercial Bank; in 1869 three banks were formed; in 1870 five banks. The articles of associa-

tion of 12 banks were approved in 1871, of 10 banks in 1872, and of 6 banks in 1873. Not all of these banks, however, undertook operations; by the beginning of 1876 there were altogether in existence 39 banks with 49 branches.

The network of commercial banks resumed its growth in 1892–1893, principally in respect to the branches. The number of banks up to 1912 fluctuated from 30 to 40.

During the latter years of their existence the number of joint-stock commercial banks began to increase again. The number of banks was as follows:

February 1st, 1912..........	34	with	691	oranches
January 1st, 1913..........	45	"	732	"
January 1st, 1914..........	47	"	743	"
January 1st, 1915..........	50	"	762	"
January 1st, 1916..........	50	"	782	"
January 1st, 1917..........	53	"	—	"

After the October Revolution the joint-stock commercial banks, it will be remembered, were nationalized by Decrees of December 14, 1917 from which time they ceased to exist as independent credit institutions. The history of the commerical banks in Russia thus embraces the period from 1864 to 1917. Confining ourselves to a description of the fundamental points of the development of the commercial banks for the period under review, we shall dwell first of all on the process of development of the banking network. In the course of 1900–1910 the number of banks not only did not grow but greatly diminished. By the beginning of 1900 they numbered 39, and by 1910 only 31. This was due to the process of consolidation of the banks which was then beginning. The most important instances of consolidation were: the merger of three " Poliakoff " banks into the Amalgamated Bank (Soyedinenny Bank) in 1909; the merger of the " Northern Bank " (Severni Bank) with the " Russo-Chinese " into the " Russo-Asiatic Bank " in 1910; the absorption of the Minsk Commercial Bank in 1909 and later the Kiev Private Commercial Bank by the Azov-Don Bank. At the same time certain provincial banks in the same decade ceased their existence, among them the insolvent Kharkov Trading Bank. From 1910 the number of banks began to grow. At the beginning of that year they numbered 31, and 45 at the beginning of 1913, and 53 at the beginning

of 1917. This happened partly as a result of the establishment of a few new banks, and partly on account of the fact that certain private banking houses were converted into joint-stock commercial banks. Among these transformations was the reorganization of the "Junker" banking house into the Moscow Industrial Bank, the banking house of Riabushinsky Bros. into the Moscow Bank, and some others.

At the beginning of 1917, there were operating in Russia, as we said before, 53 joint-stock banks, of which 15 were Petrograd banks (i.e., whose head offices were there),[7] 8 Moscow banks,[8] and 30 provincial banks. The following figures relating to the beginning of 1914 demonstrate the relative significance of these 3 groups in the money market. The resources of these banks as on January 1, 1914, were (in millions of roubles): [9]

The provincial banks, as shown by the above figures, were not of great significance in the money market. The chief position was occupied by the Petrograd banks, and next the Moscow banks.

According to volume of business the largest banks on the eve of the revolution, January 1, 1917, were (in millions of roubles): [10]

Investments in Loan and Discount Operations

Russian Bank for Foreign Trade	608.7
Azov-Don Bank	560.1
Russo-Asiatic Bank	540.5
Volga-Kamski Bank	526.7
Moscow Merchants Bank	458.4
Petrograd International Bank	440.6
Russian Trade & Industrial Bank	342.9
Siberian Trading Bank	298.7
Amalgamated Bank	238.2

7 Azov-Don Bank, Volga-Kamski Bank, Petrograd Bank, International Bank, Petrograd Trade & Commercial Bank, Petrograd Loan & Discount Bank, Petrograd Private Commercial Bank, Russian Bank for Foreign Trade, Russian Trade & Industrial Bank, Russo-Asiatic Bank, Russo-English Bank, Russo-Dutch Bank, Russo-French Bank, Siberian Bank, Crédit Lyonnais (branch), Allied Bank.

8 Moscow Bank, Moscow Merchants Bank, Moscow Narodny Bank, Moscow Discount Bank, Moscow Private Commercial Bank, Amalgamated Bank.

9 According to "General Balance" for 1914.

	Bank's own funds	Deposits and Curr. Accts.	Investments in loans and discounts
St. Petersburg Banks ...	544.9	1834.0	2102.6
Moscow " ...	151.7	467.1	695.3
Provincial " ...	139.8	237.9	364.0

10 According to "General Balance" for January, 1917.

Business of the Joint-Stock Banks. Passing to the operations of the joint-stock commercial banks and their rôle in the country's economic life, it should first of all be noted that these banks passed through different phases during the 54 years of their existence.

In the course of the first 25–30 years of their existence, before the beginning of the nineties of the last century, the joint-stock commercial banks were not very powerful institutions nor particularly important in economic life. Their relative significance in the money market in comparison with the State Bank at that time was not very great. A considerable advance in the development of the commercial banks took place in 1893–1894, when Russia entered upon a phase of economic progress, which continued up to 1899. During this period the operations of the commerical banks developed rapidly. But 1899 saw the advent in Russia of a general commercial and industrial crisis which lasted until 1902, when it evolved into a prolonged stagnation which dragged on till 1908. The crisis of 1899–1902, which was also, by the way, accompanied by a crisis on the stock exchange, delivered a heavy blow to the development of the joint-stock commercial banks. The banks' balance-sheets, the movement of their capital stocks, deposits and current accounts and loan and discount operations seemed again to have come to a standstill. The commercial banks, however, did not get off merely with a stabilization of their balance-sheets. A number of banks sustained heavy losses and found themselves in serious difficulties. Subsequent government examinations revealed that some of the big banks and their heads had been pursuing an extremely unsound policy. In some cases where there did not prove to be any way out of the difficulty things ended in a collapse.

Development of Joint-Stock Banks Before the War. The blow which was dealt at the commercial banks by the trade and industrial crisis of 1899–1902 at the same time led to a change in their relationships with the State Bank and to a decline in their relative significance on the money market. On the other hand, while the operations of the commercial banks on the asset side remained stationary during these years, the State Bank's loan and discount transactions displayed a rapid growth.

In the course of 1902–1903 the transactions of the commercial

banks somewhat increased, but subsequently up to 1906 they again subsided into a period of stagnation. The economic depression terminated in 1908. But the year 1907 already saw a resumption in the growth of the banks' loan and discount operations, an influx of deposits, a general growth of the balance-sheets, etc. From this time until the outbreak of the war the joint-stock banks were undergoing an exceptionally rapid development. At this time they grew up into powerful institutions. During that most auspicious period deposits and current accounts were almost trebled, and reached on January 1, 1914, the total of 2,539 million roubles. The loan and discount business of the joint-stock commercial banks showed approximately the same increase and amounted to 3,162 million roubles. The bank's own funds also increased by nearly three times.

The same period witnessed a decisive change in the relationships of the State Bank and the joint-stock commercial banks and the advance in their relative importance on the money market of which mention was made in the preceding chapter. The State Bank was forced to a minor position in the financing of trade and industry, which became concentrated chiefly in the hands of the joint-stock commercial banks. A considerable portion of the funds which the State Bank supplied to commerce passed through the commercial banks.

Joint-Stock Banks 1914–1917. The outbreak of the war in 1914 did not interfere with the development of the commercial banks' transactions. It was only in the first few months following the declaration of war that the banks were obliged to resort to increased borrowing from the State Bank, owing to an efflux of deposits during 1914. But the influx of deposits to the private banks began again in the last months of 1914 and waxed strongly in the course of 1915 and particularly in 1916 and 1917. This enabled the joint-stock banks to increase their investments in loans and discounts; their operations continued to develop.

This progress can be seen from the table on p. 919, which gives the figures from the aggregate balance-sheets of the joint-stock banks (in millions of roubles):

	Jan. 1, 1914	July 1, 1914	Jan. 1, 1915	Jan. 1, 1916	Jan. 1, 1917	April 1, 1917
Own capital.......	836.5	987.3	906.1	930.6	993.6	1,089.9
Deposits and current accounts....	2,539.0	1,807.8	1,873.2	3,931.1	6,747.6	7,548.4
Loan and discount operations	3,161.9	3,180.3	3,190.1	3,711.5	5,491.5	6,325.6
Total balance-sheet.	6,233.0	6,381.8	6,521.4	8,434.0	13,051.3	14,461.0

In spite of the fact that the operations of the commercial banks continued to grow in the course of 1914–17, it would be wrong to regard this period of the commercial banks' activities as a continuation of the boom of 1907–1913. The resemblance between these two periods in the development of the commercial banks' transactions is merely an extraneous one. *The development of the commercial banks' operations in the period of the war was based on the phenomenon of paper-currency inflation.* The growth of business, the increase of deposits and asset operations, was in fact an unhealthy distention and not a normal development.

THE NATIONALIZATION OF THE BANKS. The history of the Russian commercial banks and of the whole former credit system terminated with the Decree of the Central Executive Committee for the nationalization of the banks, dated December 14, 1917.

This Decree reads:

" In the interests of a proper organization of national economy and with a view to completely eliminating banking speculation and entirely liberating the workers, the peasants and entire working population from the exploitation of bankers' capital, and also with a view to establishing a single national bank of the Russian Republic to genuinely serve the interests of the nation and the poor classes, the Central Executive Committee hereby resolve:

(1) Banking is declared a State Monopoly.

(2) All existing private joint-stock banks and banking houses are to be merged with the State Bank.

(3) The assets and liabilities of the liquidated institutions are to be taken over by the State Bank.

(4) The mode of the merger of the private banks with the State Bank is to be laid down by a special decree.

(5) Provisionally, the management of the affairs of the private banks is intrusted to the Council of the State Bank.

(6) The interests of the small depositors will be fully safeguarded."

Another decree supplementing this was issued on January 26, 1918, ordering the complete confiscation of all the funds of the former private banks, and the annulment of all bank shares and prohibiting the paying out of any dividends thereon.

On the day of the publication of the Decree of December 14 the management of the joint-stock commercial banks passed directly into the hands of the representatives of the Soviet authorities, who commenced gradually to transfer their assets and liabilities to the State Bank, which eventually in 1918 was renamed the People's Bank of the Republic (Narodny Bank). Liquidating and Technical Collegiums were instituted at each of the commercial banks which were under liquidation and to coördinate the work of these collegiums a "Council of Experts" was formed at the office of the former State Bank. The nationalized banks were converted into "branch" offices of the People's Bank. They still continued certain operations in the course of 1918–1919, namely, current account business, remittances, and, to a more restricted degree, documentary commercial credits. In April, 1919, an order was issued for the granting of credits for food purchases, and for some time these transactions developed rather extensively until autumn of the same year when the granting of food credits was suspended. In December, 1919, 230 liquidation balance-sheets were received from the 340 offices of the former commercial banks which maintained contact with the center; bank values to the amount of 12.7 milliards or 94.1% of the sums of the private banks' balance sheets passed to the balance sheet of the People's Bank. In this connection the official publication of the People's Commissariat for Finance, compiled in the middle of 1920, from which we have borrowed this information, established the fact that "the business of nationalizing the commercial banks is at present completed." [11]

Mutual Credit Societies and City Public Banks. We have

[11] Vide publication of People's Commissariat for Finance "The Social Revolution and Finances" Md. 1921 pp. 72–78 (in Russian).

said above that in the field of short-term credit there were two other types of banks operating in Russia besides the joint-stock commercial banks: the mutual credit societies and the city public banks. The *mutual credit societies* were small credit institutions who catered to small and middle-class industry and trade. They were organized not on the lines of the joint-stock companies but on the basis of mutuality. The capital of these societies was forced from membership contributions. Each member of the society, however, took upon himself responsibility for the affairs of the society to the extent of ten times the amount of his membership contribution. On January 1, 1917, there were 1,031 of these societies. Societies, to the number of 795 concerning which information was available at the time, had a membership of 442,940, working capital — to an amount of 101.1 million roubles, deposits and current accounts to a sum of 991 million roubles. Their investments in bill of exchange transactions at the same date were 472.9 million roubles, and securities — 140.5 million roubles. *The city public banks* were small provincial banks under the administration of the town councils. On January 1, 1916, there were altogether 50 of these banks in Russia in the larger (gubernia) towns and 293 in the smaller (ouyezd) ones. With total assets of 347.6 million roubles, these banks invested in discounts of bills with two signatures 105.1 million roubles, in time loans against freeholds in the cities 96.5 million roubbles, in loans to towns and zemstvos 11 million roubles, in loans against securities 10 million roubles. The Mutual Credit societies and the City Public banks were liquidated by order of the People's Commissariat of Finance at the end of 1918.

Institutions of Long-term Mortgage Credit. The first big institutions of mortgage credit in Russia were the private *joint-stock land banks,* which existed up to the October Revolution. There were altogether ten of them, and all of them sprang up in the period 1871–1873. The joint-stock land banks granted long-term loans against mortgage of lands for various terms ranging from 10 to 66 years, by means of giving the borrowers their own mortgage bonds. Most of the mortgage bonds issued by the private land banks which the borrower had to realize for his own account, bore interest at $4\frac{1}{2}\%$. The borrowers, in accordance with the usual practice of mortgage credit, paid the bank, besides $4\frac{1}{2}\%$

interest for payment on coupons of the mortgage bonds, from ¼% to 8% per annum, according to the term, in repayment and from ¼% to ½% "for the setting up of the bank's reserve fund, for payment of dividends and expenses in connection with the management of the banks." The credit, in this way, would cost the borrowers 5–6% per annum. Actually it was dearer, since the mortgage bonds had a rate below their face value while interest was paid into the bank at their nominal cost.

An idea as to the general progress of the operations of the joint-stock land banks can be obtained from the following figures showing the growth of their mortgage bond circulation. The amount of these bonds was (in millions of roubles):

Jan. 1, 1909	964.6	Jan. 1, 1914	1,294.2
" 1910	1,001.9	" 1915	1,340.9
" 1911	1,094.	" 1916	1,337.8
" 1912	1,197.2	" 1917	1,313.9
" 1913	1,222.2		

To appreciate the significance of these loans in the financing of agriculture it should, however, be borne in mind that the land banks granted loans not only against farming lands, but against real estate in the towns as well. Thus, besides big land enterprises they financed building in the towns. Placing the town loans of the land banks separately, we should get the following picture of the development of their operations in the financing of big landowner enterprise. Their total loans against mortgages of lands amounted to: Jan. 1, 1903 — 537.7 m.r., Jan. 1, 1909 — 636.8 m.r., Jan. 1, 1914 — 897.3 m.r., and Jan. 1, 1917 — 946.7 m.r.

Besides long-term loans the joint-stock land banks also granted short-term loans for terms from 1 to 3 years on mortgaged land. Thus, farming enterprise of the big landowners ("Pomeschiki") received through the joint-stock land banks loans to a sum of about 1 milliard roubles nominal. Of this sum the borrowers realized on the money market probably not less than 700 to 800 million roubles.

State Nobles Land Bank. The credit of the private land banks was comparatively dear and could not save the big landowner farms, i.e., the enterprise of the "Pomeschiki," from ruin. To support the latter the *State Nobles Land Bank* was founded in

1885 by which loans were granted upon mortgaged land only to hereditary nobles. Later on, in 1890, the affairs and funds of the Society of Mutual Land Credit, established in 1866, were turned over to the Nobles' Bank where they formed the Special Department of the State Nobles Land Bank. Credit was granted by the Nobles Bank on very easy terms. The principal facility was that the bank guaranteed the borrower a fixed rate which was to be realized on the mortgage bond. At first loans were given in mortgage bonds, but the bank undertook to realize these bonds on the market at a margin of 2% in its favor, the borrower being paid 98% of the nominal value of the mortgage bond in cash. From 1889, however, the bank simply began to grant loans in cash, waiving the difference of 2% and even refunding the 2% to all the former borrowers. The bank now sold the mortgage bonds on its own account. The difference was covered from the realized proceeds obtained by a lottery loan for 80 million roubles. Thus on loans received from the Nobles Bank the borrower did not lose on the rate and the credit cost him much less than at the private land banks, notwithstanding that the mortgage bonds of the Nobles Bank bore interest at 5% while those of the joint stock banks were 4½%. Very soon the borrowers of the Nobles Bank began to receive numerous other privileges. These privileges consisted of various prolongations and deferments, writing off of arrears, and so on, and were granted from the most diverse motives. Side by side with these facilities, however, the borrowers' farms still continued to decline. About 35 to 40% of the payments yearly remained in arrear. Additional loans were continually being taken upon mortgaged property at the Nobles Bank itself. The borrowers of the Nobles Bank, receiving therefrom 60% of the value of the land, were rarely content with this loan and for the most part applied to other mortgage banks for additional credit, where loans were taken on second and third mortgages, and likewise applied to the State Bank which gave loans against promissory notes secured by land. Up to 1906 seven out of every ten borrowers who received loans at the Nobles Bank applied for loans under second and third mortgages.

The general development of the Nobles Bank's operations is expressed in the following figures. The debt outstanding on mortgaged estates (including the debt owed by the Peasants' Bank)

was: Jan. 1, 1909 — 747.2 m.r., Jan. 1, 1912 — 820.4 m.r., Jan. 1, 1914 — 954.4 m.r., and Jan. 1, 1917 — 1,010.8 m.r.

With the continuous arrearage which accompanied the operations of the Nobles Bank it could hardly be supposed that any appreciable portion of the sums which the borrowers received from that bank were employed for enlarging or improving their undertakings. Most of these funds were evidently used for other purposes. Estates, mortgaged at the bank, were gradually being sold to persons of " non noble " origin, on to whom the debt was transferred. Thus, on January 1, 1912, out of 27,256 mortgaged estates with a mortgaged area of 12.1 million desiatines, 9,732 with an area of 2.2 million desiatines belonged to persons not of the nobility, i.e., they were sold by the nobles, who had taken loans, to persons of other classes. Moreover, with a debt of 678.9 million roubles owed by borrowers the Nobles Bank at that time had a debt owed it by the Peasants' Bank of 151.5 million roubles in respect of estates which had passed over to the peasants. Thus about one-third of the funds were received from the bank by persons who sold their estates and in this way took their capital away from the land. Moreover, of the remaining two-thirds hardly much could have been used on agriculture if for the reason alone that in 1896–1900, for instance, only 29% of the estates which remained mortgaged at the Nobles Bank in 46 gubernias of European Russia were cultivated exclusively for account of the owners, while of the remainder 51% were exploited by leasehold and 20% in mixed ways. It is difficult to believe that the bulk of the landowners would apply for loans and mortgage their lands with the aim of improving and enlarging enterprises which they exploited by means of lease. All these funds, obviously, were employed for different purposes not connected with agriculture.

Peasants' Land Bank. In 1883, a little before the Nobles Bank, there was established the Peasant's Land Bank. The aim of the bank was to facilitate the process of mobilization of land property, i.e., the passing of the land from big proprietors to the peasants. A part of the cost of the land was to be paid by the peasants, the bank providing the rest. This money went to the former owners, who retired from the land and took the money away with them into the towns to be applied in trade and industry. The new owners had to pay into the bank interest and

redemption. These payments were fairly large and comprised at first from $7\frac{1}{2}$ to $8\frac{1}{2}\%$ and eventualy from 1894 $6\frac{1}{2}$ to $7\frac{1}{2}\%$ per annum. The following figures show the sums received by landowners for their lands through the Peasants' Bank:

Years	Loans Granted: For purchase in thous. des	Loans Granted: To total amount (in thous. rbs.)
1883–1885	546.2	24,152
1886–1888	704.7	23,778
1889–1891	491.3	12,650
1892–1894	486.2	15,475
1895–1897	784.0	34,454
1898–1900	2,125.0	134,557
1901–1903	2,210.3	170,052
1904–1906	1,486.2	134,410
1907–1909	3,179.0	368,614
1910–1912	3,864.7	414,025
1913–1915	1,894.6	———

Up to 1915 inclusively altogether 17.7 million desiatines were purchased through the Peasants' Bank. Up to 1912 loans were granted for the purchase of land to an aggregate amount of 1,329 million roubles.

In 1895 the Peasants' Bank was subject to a reform as a result of which it was given the right to buy land for its own account to be subsequently resold to the peasantry. This measure had the aim of increasing the demand for land with a view to raising its price. This aim was indeed achieved and prices on land began to rise. At first the Bank was able to buy land on its own account only with its own resources, but in 1905 it was allowed to effect such purchases on account of mortgage bonds specially issued for the purpose. Eventually certain government lands were turned over for sale to the Peasants' Bank, so that it found itself in possession of a large land fund which in the last few years preceding the war was steadily sold off. The land fund of the Peasants' Bank was: Jan. 1, 1909 — 4,478 thousand desiatines, Jan. 1, 1913 — 2,930 thousand desiatines.

From 1907 the Peasants' Bank began to grant loans against mortgages of peasants' allotments, which had by that time freed themselves on the old redemption payments imposed on them in 1861 at the time of the abolition of feudal rights. These

were essentially the first loans to fall into the hands of the peasants, who could employ them to productive ends. This operation, however, did not develop particularly well. Such loans were granted as follows:

Years	Number of loans	Amount of mortgaged land (in thous. of des.)	Loans granted (in thous. of roubles)
1907	47	32.0	504.6
1908	153	36.1	1,765.1
1909	952	53.9	1,089.1
1910	1,113	45.6	1,213.1
1911	1,083	23.4	1,116.4
1912	1,388	22.9	1,078.4

We have seen that for the same years the Peasants' Bank had granted loans for the purchase of land to a sum of 782.6 million roubles. The money which the peasants received direct from the Peasants' Bank thus amounted to less than 1% in comparison with the sums which were received by those who sold their land to the peasants and retired from agriculture. During the subsequent years, 1913–1916, the operations of granting loans to the peasant did not develop.

From the above-quoted figures illustrating the activities of the principal banks of land credit in Russia it can be gathered that, generally speaking, this form of credit was fairly well developed. On January 1, 1916, the indebtedness of private owners to the joint stock land banks amounted to 947.8 million roubles, to the Nobles Bank 854.0 million roubles, while the debt to the Peasants' Bank on peasant lands amounted to 1,398 million roubles, i.e., altogether 2.2 milliard roubles. If we add hereto the debts to certain other institutions of mortgage credit we would get a total indebtedness for 46 gubernias in European Russia on January 1, 1916, of over 3 milliard roubles.

Town Credit Societies. In the sphere of long-term credit an important rôle was still played in Russia by the *town (and gubernia) credit societies.* They resembled, in their activities, the land banks, operating by help of the issue of their bonds, except that the land banks granted loans both against the pledge of farming estates and real estate in the towns, whereas the town credit societies granted loans exclusively against mortgages of town freeholds. In respect of their organization, how-

ever, the town credit societies differed substantially from the joint-stock land banks, being attached to and under the control of the town self-governing bodies. The proprietors of the societies were their members, who elected once in every three years the meeting of representatives, and the members of the societies were owners of property mortgaged to the societies. On July 1, 1916, there were 36 town credit societies in Russia, including 12 in Poland. Their loans to borrowers outstanding at that date amounted to 1,361 million roubles. The total amount of loans granted by the town credit societies and the land banks for building in the towns comprised on January 1, 1914, 1,756 million roubles and on January 1, 1916, 1,804 million roubles.

After the October Revolution the system of mortgage credit was also liquidated. One of the first acts in this connection was the decree of November 25, 1915, abolishing the Nobles' Bank and Peasants' Bank, which was published a few weeks before the decree concerning the nationalization of the banks dated December 14 (27), 1917. Next was issued the Decree of the Council of People's Commissaries of May 17, 1919, concerning the liquidation of the town and provincial credit societies.

Small Credit Institutions. In Russia before 1917 there existed three types of small credit institutions: (1) *peasant public institutions* of small credit, under which category were included auxiliary and savings banks, volost and village public savings banks, volost and village banks, and some others; (2) *zemski kassi* of small credit (small banks of zemstvos); and (3) *credit coöperatives of two types,* namely, *credit associations* (Kreditnie towarischestwa) and *loan-savings* associations (sudosberegatelnie towarischestwa). Among the institutions of small credit should also be added the *State* (Ssudnie Kassy) and *Town Lombards.*

All these three types of institutions, peasant public, zemski and coöperative, catered approximately for the same sphere of enterprises — small and medium farms of the peasantry in the villages and the enterprises of handicraftsmen and petty traders in the towns. They furnished loans for economic improvements, for the purchase of tools and equipment, raw material necessary for the enterprise, and other similar requirements. Loans were granted as personal trust, on surety, or on pledge. Occasionally loans

were made against mortgages on real estate. In most cases loans were granted for terms ranging from 9 to 12 months, but a certain portion were granted for longer periods, up to 5 years. All the institutions of small credit operated both with their own as well as outside funds, consisting partly of deposits and partly of borrowed money. The latter they received from private individuals, or public organizations, or from other credit institutions.

The *Peasant public institutions of small credit* represented small cash offices with a capital of a few thousands, rarely more than a few tens of thousands roubles, which were under the peasant self-governing bodies in the rural districts. Their number was considerable; on January 1, 1914, there were 4,724 institutions of this kind operating in the country. Their rôle, however, in the country's economic system was insignificant. It is sufficient to say that their total investments in loans at that date amounted to 100.5 million roubles. The *Zemski Kassi* of small credit were under the gubernia and ouyezd zemstvos. Their basic capital was comprised of the appropriations of the institutions of zemstvos and the relief which the government issued for this purpose. Besides this they received deposits. Their business was of a larger volume than that of the peasant institutions. On January 1, 1916, there were 247 zemski kassi in Russia with a capital of their own amounting to 3,164,000 roubles. At this date their loan investments amounted to 59.9 million roubles.

Credit Coöperative Societies. *Credit coöperatives* began to spring up in Russia in the sixties of the last century. The first loan and savings association was established in 1865 by the brothers Sviatoslav and Vladimir Luginin in the village Dorovatov, government of Kostroma. The number of credit institutions subsequently began to increase in the following manner. There were in:

1865	1	1890	826	1915	15,450
1870	12	1900	785	1916	16,055
1875	568	1905	1,629	1917	16,477
1880	902	1910	6,693		
1885	988	1914	14,562		

The largest increase took place in the period after 1905.

The loan-savings and credit associations were organized on the following basis.

The proprietors of the association were its members, and managed its affairs through the general meeting and its elected bodies: the Board and Council. Only members of the association could enjoy credit therein. The association had a basic capital, which was formed differently in the loan and savings and the credit associations; this in fact constituted the principal distinction between these two types of credit coöperatives. The loan and savings associations were built up on a contributed capital comprised of the contributions of the members. Each member was obliged to contribute a uniform fee either on admittance to the membership of the society or by subsequent payment. Under the old charters this contribution could not be more than 100 or less than 10 roubles. In addition to the contributed capital the association may have had other sums in its basic capital, such as donations or sums specially loaned for the purpose. Thus, the association, besides the contributed capital had *a basic* capital, made up from other sources and also borrowed capital. In the course of time the associations formed also *reserve* funds and special funds out of allocations from the profits. The credit association was not obliged to have a contributed capital. Its members did not make obligatory contributions. Its basic capital, which might not be less than 1,000 roubles, could be made up from borrowed money on the one hand and from sums donated and appropriations from the profits on the other. Thus the basic capital of the credit associations as well was comprised of *own capital* and *borrowed funds*. It should be pointed out that in the event of the association's liquidation the sums borrowed for building up the basic capital were to be returned to the lenders only after the society's other debts, such as deposits, loans for business requirements, etc., had been paid off. The members of the credit associations, in addition to the contributions which they made, bore a certain additional liability for the business of the association. This liability might be limited or unlimited. In the latter case it could not be less than double the amount of the maximum credit fixed for the respective member. Thus, the credit and loan-savings associations, apart from the basic capital, which they actually formed, had an additional *guarantee capital*. The credit coöperatives received deposits for fixed periods and ordinary deposits and contracted short-term loans.

In the sphere of their asset business the credit and loan-savings associations were remarkable first of all for the fact that the volume of credit they were able to give to the individual member was limited. Under the old charter the maximum credit could not exceed 300 roubles, and only in separate cases reached as much as 1,000 roubles per member. Moreover, their asset business was circumscribed by the range of their loans, i.e., they could grant loans only for specific purposes, such as " for business turnover and improvements in the enterprise, as well as for the purchase of machinery, tools, livestock, and any equipment necessary for agriculture or other trade." This restriction had the aim of preventing loans being given for consumptive needs. Each prospective borrower had to state for what purpose he required the loan. It may be presumed, however, that in practice this restriction had no special significance, and probably resolved itself to a mere formality. The credit coöperatives furnished two kinds of loans: short-term loans for a term up to one year, and long-term loans for terms up to five years.

The coöperative principle was applied by the loan and credit associations in the matter of allotting profits, although in this connection there existed a substantial difference between these two types of coöperatives. The loan-savings associations could pay dividends on contributions, but not more than 10%, while the credit association did not pay its members any profits. All the profits of the credit associations and those of the loan-savings associations, less dividends, had to go to the forming and supplementing of the society's own capital and could be employed by the association in excess of this for charitable and similar purposes. In this manner, the associations, after a certain time lost some of their interest in accumulating profits. Its policy in this case had to be that of making credit for its members as cheap as possible.

To conclude the description of the old Russian credit and loan-savings associations, we must add that they were not purely credit institutions, since in addition to credit functions they acted as brokers and agents to their members in selling their merchandise and buying for them raw materials, etc. With many of the credit coöperatives these brokers' transactions occupied a more prominent place than purely credit business.

In the last years preceding the revolution, owing to the increase in the number and development of the activities of the credit coöperatives, a tendency became noticeable on the part of the credit coöperatives of one district or province to amalgamate into *Unions of credit coöperatives*, or so-called *credit coöperatives of the 2nd degree.* This whole system of coöperative credit became unified into a single chain after the establishment in Moscow of a central bank of coöperative credit in the shape of the Moscow Narodny Bank.

An idea as to the activities of the credit coöperatives and loan and savings associations during recent years preceding the revolution is given by the following data.

The general returns of the credit and loan and savings associations were as follows:

	Number of associations included in general balance sheet	Membership	Contributed (own) Capital	Deposits	Loans
		(in millions of roubles)			
On Jan. 1, 1913.					
Credit Associations..	7,964	4,870,351	——	113.5	184.5
Loan & Savings Associations........	3,062	1,740,229	——	170.2	212.8
On Oct. 1, 1915.					
Credit Associations..	11,344	7,784,361	20.2	254.0	355.4
Loan & Savings Associations........	4,005	2,317,864	48.7	206.7	269.8

An idea of the interest which the credit and loan-savings associations paid to their depositors can be obtained from the following data, as at the beginning of 1915:

Up to 4%	was paid by	34	credit assoc. and	48	loan & savings assoc.
" 5%	" " "	245	" " "	389	" " "
" 6%	" " "	1416	" " "	953	" " "
" 7%	" " "	3457	" " "	873	" " "
Over 7%	" " "	5099	" " "	1263	" " "

The majority of the associations thus paid on deposits 7 and more per cent, i.e., at least 3 to 4 per cent more than the commercial banks. Under these conditions the credit coöperatives charged their borrowers 9 to 10 and more per cent.

Deposits were coming in chiefly from private individuals.

The total sum of deposits which the credit coöperatives disposed of on January 1, 1915, were received from the following sources:

	At Credit Associations (in millions of roubles)	At Loan & Savings Associations (in millions of roubles)
From private persons	196.00	199.20
" private banks	0.10	0.08
" institutions of small credit	3.40	1.60
" zemstvos	0.03	0.01

Attitude of Soviet Government toward Small Credit Societies. The measures of the Soviet Government in connection with the *liquidation* of the banks were not applied to the small credit institutions of the coöperative type. On the contrary, in the early part of 1919 an order was issued (People's Commissary of Finance, February 2) regarding the registration of the charters of all credit coöperatives, which demanded that the charters of newly organized credit coöperatives and loan-savings associations and their unions be submitted for registration, and stipulating that "such charters as have been approved or registered in the regular way before October 25, 1917, are not subject to obligatory revision and re-approval or reregistration." Nevertheless, the coöperative credit institutions in the course of 1918–1919, owing to the suspension of free commercial intercourse and the sharp depreciation of the currency, ceased to be of any importance whatsoever. The Decree of January 27, 1920, regarding the amalgamation of all kinds of coöperative organizations enjoined that "the credit and loan-savings coöperative associations, as well as their district, provincial, and regional unions, are to be merged with the local consumers' societies and their unions, to whom they are to turn over their assets and liabilities, technical equipment, and personnel."

THE NEW BANKING SYSTEM OF THE U.S.S.R.

Founding of the New State Bank. The financial policy of the Soviet Government in the early years after the October revolution, during the epoch of so-called "military communism," culminated in the liquidation of the old credit institutions.

With the liquidation of the credit institutions the various credit instruments disappeared from the economic system. Bills and checks, securities and drafts, etc., all were elements of which the majority of people engaged in business retained but the vaguest recollection in 1921. The financing of the nationalized enterprises was, as is known, carried on under the budgetary allocations system, by way of non-repayable grants through the organs of the Treasury, in compensation for which these enterprises delivered their produce to the corresponding Government authorities free of charge. In private business, where it still existed, deals were only made in cash both on account of the absence of laws regulating credit transactions and the continual depreciation of the monetary unit. The keeping and transfer of money relapsed to primitive methods. The change in the economic policy of the Soviet Government, the transition to the N.E.P. could not fail to produce a change in the Government's attitude towards credit. It became clear that the supplying of funds to big enterprises could no longer be carried on fully by way of budgetary appropriations and that the nationalized enterprises would have gradually to return to the system of obtaining working capital by means of credit. At the same time, with the organization of a commodity market and the licensing of private capital investment in trade, and, to some extent, in industry, a demand was created for the restoration of the credit system as a machinery for facilitating cash transactions. At the same time a change of opinion became noticeable in regard to the currency. The opinion prevalent hitherto that it was necessary to abolish the currency system was superseded by the idea of having this system restored and adjusted, which could not be done in the complete absence of credit in the country. For these reasons the necessity for restoring the credit system became obvious, and the idea arose of establishing a State Bank. During September 1921 a Regulation for the new bank was hurriedly drafted which, after being examined by several committees, was approved by the All-Russian Central Executive Committee on October 3rd. On October 12 the Council of People's Commissars passed a decree establishing the State Bank of the R.S.F.S.R. — later renamed State Bank of the U.S.S.R. in connection with the formation of the Union of Soviet Republics. A little later the Central Execu-

tive Committee finally confirmed the "Regulation for the State Bank." On November 16, 1921, the Bank started business in Moscow and proceeded at once to organize branches in other towns. On January 1, 1922, the bank already had 21 local offices and branches opened. The main object of the new institution was defined by Article 1 of the Regulations which states that the State Bank was organized with the aim of "promoting by means of credit and other banking operations the development of industry, agriculture and trade and concentrating monetary transactions and fulfilling other measures for establishing a sound currency."

Inception of Other Credit Institutions. The State Bank was the first credit institution to spring up under the new conditions. Its inauguration was followed by the establishment of other banks and soon a considerable network of credit institutions was formed in the U.S.S.R. In general the following types of credit institutions existed in the U.S.S.R. in 1928.

(1) *Banks of the joint-stock* type, the largest of which is "The Bank of Long-Term Credits for Industry and Electrification of the U.S.S.R." ("Prombank") with the Head Office in Moscow. This type also includes the "Bank for Foreign Trade of the U.S.S.R." ("Wneshtorgbank") with the head office in Moscow, the "Far Eastern Bank" (head office Habarovsk), and others;

(2) *The Central Agricultural Bank;*

(3) Banks of the *coöperative* type, including the All-Russian Coöperative Bank (Vsekobank) and the Ukrainian Bank;

(4) *City Banks* (Moscow City Bank, Leningrad Communal Bank, Kharkov City Bank, Nijni-Novgorod City Bank, Vologda Communal Bank, etc.,) as well as the Central Bank for Municipal Economy and Building;

(5) *Mutual Credit Societies;*

(6) *Agricultural Credit Societies,* of which there were 70 by April 1, 1928;

(7) *Credit and agricultural credit* associations;

(8) Town Lombards, of which by April 1, 1928, there were 36.

(9) *Savings Banks.*

The Prombank. The Prombank commenced its activities at the end of 1922 with an initial capital of 3.4 million roubles nomi-

nal, as a bank of short-term credit. Subsequently, further issues of shares were made and on October 1, 1925, the bank's capital comprised 74.4 million roubles. Although it is a joint-stock bank in form the Prombank is on the whole a State credit institution, since almost all its shares belong to State institutions and enterprises. By its aims the Prombank is an institution which is supposed to cater for the credit needs of State industry. In this sense it is the bank of the Supreme Council of National Economy which has a very close control of its activities. Until 1928 the Prombank granted loans to State industrial enterprises both in the form of short-term loans to satisfy their needs for circulating capital, and in the form of long-term loans for the development of industry. For the latter aim there existed in the Prombank from the year 1926 a special Department for Long-term Credits. But in view of the fact, that short-term loans are largely granted to State industry by the State Bank of the U.S.S.R., there was some parallelism in the work of the State Bank and the Prombank in this respect. To avoid this in 1928 the Prombank was reorganized into a Bank of purely long-term credits for industry, and its short-term assets and liabilities were taken over by the State Bank. The Prombank is now receiving its working funds from State Budget grants allotted for new industrial building, from the assignments out of the profits of State industrial enterprises and so on. From these funds the Bank grants loans in the form of long-term credits to different State trusts and other State organizations, which need credits for the purpose of new buildings and of enlarging existing plant.

Central Agricultural Bank. The Central Agricultural Bank commenced operations in Moscow in July, 1924. Its initial capital was provided in the form of a grant of 40 million gold roubles out of the funds of the Treasury. Besides this it was granted considerable credit by the State Bank. The object of this bank is to give credit to peasant farms for the purchase of necessary farming implements, to provide them with initial working capital and facilitate the marketing of farming produce. The bank does its work through the Agricultural banks of the constituent republics of which there were 6 banks on April 1, 1928, and the "Agricultural Credit Societies" which are ultimately based on the peasant credit and agricultural credit associations.

All-Russian Coöperative Bank. The largest bank of the coöperative type is the All-Russian Coöperative Bank ("Vsekobank"). The founders of this bank, which was established in 1922, are the so-called "coöperative centers"; Centrosoyuz, Selskosoyuz, Vsekoles, Vsekopromsoyuz, etc. The object of this bank is to supply credit to all forms of coöperative societies.

Moscow City Bank. Of the credit institutions of the fourth group — the municipal banks — the most important is the Moscow City Bank. This bank began business in Moscow at the beginning of 1923 in the form of a joint-stock bank with a capital stock of 2.5 million roubles which it subsequently increased by further issues. The Moscow City Bank is connected with the Moscow Soviet and receives considerable funds from the municipal institutions and undertakings. Like other city banks, it fulfills certain treasury functions in connection with the local budget and it frequently becomes the temporary depositary of idle funds of the city budgets.

Mutual Credit Societies. A peculiar place in the credit system of the U.S.S.R. is occupied by the *Mutual Credit Societies,* for they are the only credit institutions catering to private trade and industry and are in the closest contest with the private money market. Not getting, directly or indirectly, any assistance from the budgetary sources which to a greater or less degree go to replenish the resources of the other banks, and as they receive comparatively small credit from the State Bank, the mutual credit societies are obliged to pay the market rate of interest on their current accounts and charge a high rate for their loan business. Mutual credit societies, which differ little constitutionally from the former institutions of this type, began to appear in Russia as early as in 1922. The first — the Leningrad Mutual credit society — sprang up in June 1922. On April 1, 1928, there were 266 of these societies functioning in the country. However, the business of the Mutual credit societies is developing slowly and they are institutions with a very small volume of business.

An idea concerning the general development of the credit system in the U.S.S.R. can be gathered from the following data on the operations of different credit institutions (in millions of roubles):

	Own Capital				Deposit and Current Accounts				Loan and Discount Operations			
	1/x.1924	1/x.1925	1/x.1926	1/x.1927	1/x.1924	1/x.1925	1/x.1926	1/x.1926	1/x.1924	1/x.1925	1/x.1926	1/x.1927
The State Bank........	125.2	153.1	192.6	368.7	308.1	733.3	867.9	1,020.9	598.5	1,408.9	1,736.1	2,358.1
Central banks......... (Prombank, Wnesh-torgbank, Vsekobank, Elektrobank)	65.5	129.7	194.7	292.7	149.9	337.3	241.7	260.6	252.8	539.2	616.9	910.6
City banks............	16.1	91.2	189.6	146.9	70.2	147.0	219.6	206.8	103.5	265.2	506.2	829.1
Banks in the Provinces. (Dalbank, the Ukrain-bank and others)	13.6	16.3	19.4	23.5	19.7	34.0	32.5	39.6	29.6	53.2	65.5	88.7
Agricultural banks	48.3	119.5	216.2	279.6	7.7	41.5	64.3	95.0	103.2	389.9	758.0	1,261.6
Mutual credit societies..	3.0	7.2	15.1	13.9	5.2	17.9	27.0	22.1	10.0	29.8	48.8	31.1
Total............	271.7	517.0	827.6	1,125.3	560.8	1,311.0	1,453.0	1,645.0	1,097.6	2,686.2	3,731.5	5,479.2

These data show that business of the credit institutions during 1924–1927 developed rapidly. Deposits and current accounts increased from 560.8 million roubles on October 1, 1924, to 1,645.0 million roubles on October 1, 1927, and loan and discount operations from 1,097.6 million roubles to 5,479.2 million roubles.

Together with the absolute growth of the operations of the credit institutions their relative importance in comparison with the State Bank is slowly but steadily increasing. This can be seen from the following comparative figures of loan and discount operations:

	Loan and discount operations of State Bank	Loans and discounts of other credit institutions	Percentage of column 2 to column 1
Oct. 1, 1923	312.3 m.r.	134.7 m.r.	43.1
" " 1924	598.5 "	499.3 "	83.4
" " 1925	1,425.1 "	1,276.4 "	89.9
" " 1926	1,918.2 "	1,913.1 "	100.0
" " 1927	2,358.1 "	3,121.1 "	132.4

The percentage of the loan and discount transactions of all other banks to those of the State Bank indeed increased perceptibly in 1923–1924, although in the next years 1924–1925 and 1925–1926 it rose more slowly in spite of the fact that the network of credit institutions had considerably grown during this time.

Business of the State Bank. The Issue of the Chervonetz.[12] Having described the general trend of the credit system in the U.S.S.R. we shall now dwell at somewhat greater length on the activities of the central institution of this system — namely, the State Bank. The latter not only acts as the central bank of note issue and cashier to the Treasury, but it is at the same time the chief bank of short-term commercial credit. In describing the activities of the State Bank we shall deal in particular with the monetary reform which was carried out in the U.S.S.R. in 1922–1924.

Two Stages of Currency Reform. The State Bank, which began operating at the end of 1921, commenced business under the conditions of depreciating currency which were described in

[12] For fuller information concerning the activities of the State Bank in the early years of its existence see the author's book, *Russian Currency and Banking. 1914–1924* (P. S. King & Son, London, 1925). Ch. IV–V and VII.

the first chapter. This situation, which was extremely embarrassing for industry as a whole, greatly hampered the work of the State Bank, as a credit institution. Inasmuch as the depreciating rouble was the only circulating medium and unit of account, every loan that was granted, even for a very short time, in nominal roubles, returned to the Bank considerably depreciated in value and the Bank was therefore obliged to employ complex devices in its credit policy in order to protect its funds from depreciation. The summer of 1922 saw the commencement of work at the State Bank for preparing the monetary reform, which began to materialize at the end of the same year. This reform, as we have remarked, passed through two stages. The first was the issue at the close of 1922 of new money — the "chervonetz," bank notes of the State Bank. For 15 months afterwards the new bank note of the State Bank issue, the exchange of which had acquired a certain degree of stability in relation to foreign currency (the dollar) and to commodities, circulated in the country *side by side* with the old money, the so-called "Sovznaks" (Soviet tokens) issued by the Treasury which continued to depreciate rapidly both in relation to commodities and in relation to foreign currency (and hence, in relation to the chervonetz). Eventually, in February–May, 1924, the old money "Sovznaks," were finally liquidated and, for the purpose of small change there were issued Treasury notes which were actually exchangeable for chervonetz at their face value. From this time, i.e., February–May, 1924, the stabilization of the currency of the U.S.S.R. was completed.

THE ISSUANCE OF BANK NOTES. The issue of bank notes by the State Bank, which commenced on November 27, 1922, is based on the following principles, as expressed in the Decree of October 11, 1922, and elaborated in the supplementary "Regulations for the issue, use, and calling-in of bank notes" dated October 19, 1922.

(1) Bank notes are to be issued by the State Bank in notes of 1, 2, 3, 5, 10, 25 and 50 chervonetz and to be expressed in gold, one chervonetz being equal to 10 roubles of the former Russian gold coinage, i.e., 1 zolotnik and 78.24 dolya of fine gold.

(2) Bank notes are to be secured to not less than one quarter

of the amount placed in circulation by precious metals and stable foreign currencies. The remainder is to be secured by easily marketable goods, short-term bills and other short-term securities, and not less than two-thirds of this part of the security shall consist of trade bills.

(3) Bank notes, according to the idea of the Issue Law, must in due course be exchangeable for gold. However, at the present time they are not convertible, and the law only specifies that the date for gold payment against bank notes is to be fixed by a special Act of the Government.

(4) The chief object of the issue of bank notes is to increase the working capital of the State Bank to enable it to develop its commercial transactions, discount bills, grant loans, buy precious metals, foreign currencies, drafts and foreign bills and securities. At the same time the State Bank may also issue notes for granting short-term loans to the People's Commissariat of Finance. These loans must be secured by precious metals up to not less than 50 per cent.

(5) Information concerning the amount of bank notes put into circulation and cover for same is to be published by the Head Office of the State Bank twice a month.

(6) For administering the note issue an Issue Department is to be formed at the State Bank with a special balance sheet of its own; an Issue Council is to be formed at the Bank for exercising a general supervision and control of the issuing activities.

We have seen that side by side with the State Bank's chervonetz there were still current *old* Soviet notes which were still being issued by the Treasury. For fifteen months there thus existed in Soviet Russia a system of parallel circulation of two paper currencies. Between the two currencies there was no exchange rate fixed by law, and the exchange rate of the chervonetz in Soviet roubles was continually rising. The principal motive which decided the Government to retain the old money and the old emission side by side with the new, was that the issue of paper money was considered essential as a means of covering the large budgetary deficit which existed at the time.

Growing Importance of Chervonetz Issue. Beginning with 1923 there is to be observed a steady advance towards the pre-

domination of the chervonetz in the general volume of currency. At the same time the chervonetz issue resulted in the increase in the value of the total volume of money. By 1922 the value of this currency fell to an insignificant figure. With the transition to the new currency — the chervonetz displayed a certain amount of stability, and the value of the money in circulation increased together with its issues. In this manner was gradually removed one of the most distressing consequences of the paper money system — the acute shortage of circulating media in business. The value of the total volume of currency which comprised on January 1, 1923, 118 million roubles gold increased by January 1, 1924, to 305 million roubles, by Jan. 1, 1925, to 743 m.r., by Jan. 1, 1926, to 1,269 m.r., by Jan. 1, 1927, to 1,413 m.r., by Jan. 1, 1928, to 1,668 m.r. and by April 1, 1928, to 1,518 m.r.

As we have said, during 1923 and the beginning of 1924 there existed in the U.S.S.R. two *parallel* paper currencies, the chervonetz and the Soviet rouble. The former were issued by the State Bank in accordance with the law of October 11, 1922; the latter were issued by the Treasury. The peculiarity of the currency system of the U.S.S.R. did not, however, consist in the fact that there were two paper currencies issued in different ways. In this respect there were not a few analogies during the period of the war, notably in the issue of Bank of England notes and Currency notes in England. The distinctive feature of the Russian currency system was that the two monetary units *were not connected by an obligatory exchange rate.* The chervonetz had its exchange rate in Soviet roubles, which changed from day to day on the basis of market valuations. The chervonetz was quoted in Soviet roubles just the same as the pound sterling or the dollar. At the same time the rate of the Soviet note in relation to the chervonetz, as well as to foreign currency and commodities kept on falling rapidly all the time. In relation to the chervonetz the Soviet rouble depreciated 171 times during 1923. Thus, during this period, there were two kinds of paper money current, one more or less stable and the other continually depreciating. In every cash-office there was both good and bad money, prices were expressed in both, and both actually served as a medium of circulation.

THE MONETARY REFORM OF 1924. This gave rise to various inconveniences, and at the end of February, 1924, the Soviet Government set itself to liquidating this parallelism and unifying the monetary system.

The following are the fundamental laws and regulations by which this was enacted:

(1) *Decree of February 5, 1924, relative to the issue of Treasury notes.*

This decree laid down that the People's Commissariat of Finance shall issue Treasury notes in 1, 3, and 5 roubles gold which shall be legal tender for all transactions. The amount of these notes issued by the Treasury at the 1st of each month shall not exceed one-half of the amount of chervonetz issued by the State Bank at that date. The amount of Treasury issues is published monthly.

(2) *Ruling of the Central Executive Committee and the Council of People's Commissars of February 14 relative to the cessation of printing of Sovznaks.*

This law ordered the stoppage as from February 15, 1924, of the printing of Soviet tokens which do not represent any stable value, and of their issue from the reserves of the Commissariat of Finance; supplies of these notes remaining unissued on that date were to be destroyed.

(3) *Decree of February 22, 1924, on the issue of silver and copper coin.*

By this decree the Commissariat of Finance is charged to proceed to issue silver and copper coins of the Soviet pattern, the former for 10, 15, 20, and 50 copecks and 1 rouble; the latter for 1, 2, 3, and 5 copecks.

(4) *Ruling of the Council of People's Commissars of March 7, 1924, on the withdrawal of Sovznaks.*

In conformity with this ruling the Soviet monetary tokens were to be withdrawn from circulation. For their redemption a fixed rate was established from March 10, 1924, of 50,000 roubles of the 1923 issue (or 50,000,000,000 old roubles) for 1 rouble gold.

(5) *Ruling of the Council of People's Commissars of March 22, 1924, fixing the date when the circulation of Sovznaks shall cease.*

By this ruling Soviet notes ("Sovznaks") of the 1923 issue remain legal tender at the rate of 50,000,000,000 roubles for 1 rouble gold up to May 10, and will be exchanged at the Treasury offices and at the State Bank until May 31, 1924. Thus, the Sovznaks ceased to be legal tender from June, 1924.

(6) *Notice of the State Bank of the U.S.S.R. regarding the acceptance of Treasury notes, February 7, 1924.*

The laws enumerated above did not put the State Bank under any obligation to accept Treasury notes in the same way as chervonetz at the rate of 1 chervonetz per 10 roubles. This measure was enforced by an order of the Board of the State Bank. The Bank gave notice that it would accept Treasury notes for all payments without limitation at the rate of 1 chervonetz per 10 gold roubles and likewise freely exchange chervonetz for Treasury notes at the same rate.

Control of Treasury Note Issue. With the liquidation of the Soviet note the issue of currency was legally being carried on as before by two institutions: chervonetz were being issued by the State Bank and Treasury notes by the People's Commissariat of Finance (the Treasury). In this respect we have in the U.S.S.R. approximately the same relation as existed in England between the Bank of England notes issue and the Currency notes. In 1925 a further step was taken in the direction of *technically* linking both emissions, and from that time the issue of Treasury notes and coin has been carried on by the State Bank for account of the People's Commissariat of Finance.

The crux of the reform was to keep the Treasury note from depreciating in relation to the chervonetz, and maintaining the rouble always as one-tenth part of the latter with the same stability in regard to commodities and foreign currency. This was to be attained by two means: (1) restricting the issue of Treasury notes to one-half of the chervonetz issue; (2) the acceptance of Treasury notes in payment by the State Bank and the exchange of chervonetz for Treasury notes. These measures proved to be sufficient, and since the reform of 1924 both species of monetary tokens are freely taken and exchanged one for the other at the rate of 10 roubles per one chervonetz, and the Treasury note is current neither at a premium nor a discount in relation

to the chervonetz. During the first few months following the reform, when the issue of Soviet notes had been stopped, there was at one time a shortage of small change, especially in the provinces, and in April, 1924, a " small change crisis " arose; in other words, the Treasury notes circulated at a premium against chervonetz. In May and June, 1924, however, as the issue of Treasury notes increased, this crisis passed over.

Credit Business of the State Bank. Passing to a more detailed examination of the State Bank's operations for 1923–1928 we shall first of all perceive the importance which the issue of chervonetz had in this respect. The transition to a stable currency enabled the State Bank first of all to *put its asset transactions on a firm basis of calculation.* Elements of this system of calculation obtained in the operations of the State Bank as early as in 1922, in accounts kept in foreign currency, in loans based partly on " a gold calculation," etc. The placing of business on the basis of a stable currency calculation arrested the process of depreciation of the State Bank's balance and the year 1923–1924 saw the commencement of a rapid accretion. Simultaneously the Bank's importance in the national economy of the country increased, and found expression first in the continuous increase in the resources of the State Bank during 1923–1927. At the beginning of 1924 they amounted to over 1 milliard roubles; during 1924 they were almost doubled; in 1925 they almost doubled again, at the beginning of 1926 reached almost 4 milliard roubles and to Jan. 1, 1928, they amounted over 5½ milliard roubles.

Another influence which the transition to the chervonetz had on the business of the State Bank was that the issue of bank notes was in itself a fresh resource. During the first year of its activity the State Bank operated almost exclusively with the funds of the Treasury and with sums placed with it on deposits and current accounts, and even these were for the most part Treasury funds. The note issue itself was a large resource for the State Bank, a resource which placed at its disposal at the beginning of 1928 as much as 1,044 million roubles.

Finally, the transition to the chervonetz brought a considerable flow of deposits to the State Bank. The carrying of current accounts in chervonetz removed the obstacles which had hitherto

hindered the influx of "money from outside," since deposits were no longer subject to depreciation and business concerns were encouraged to keep their cash at the Bank. The year 1923 saw the beginning of a rapid growth of deposits.

The progress of the State Bank's operations for 1923–1928 is seen from the returns, and we shall now dwell at somewhat greater length on the various items.

The Bank's own funds on April 1, 1928, amounted to 365.6 million roubles. These include the Bank's capital, reserve fund, and other reserves. The capital was fixed on October 1, 1923, when the balance-sheet was finally placed on a gold basis, at 50 million roubles. It was subsequently increased on October 1, 1924, to 100 million roubles and on July 1, 1927, to 250 million roubles. The Reserve Fund on April 1, 1928, comprised 100 million roubles.

The chief resources of the State Bank during 1923–28 were the *Bank Note Issue* and *Deposits and Current Accounts.* Among the deposits of the State Bank, an important place is occupied by the *deposits and current accounts of the People's Commissariat of Finance,* i.e., funds of the Treasury.

A more detailed illustration of the composition of the State Bank's deposits is given by the following figures showing the distribution of deposits and current accounts by groups of depositors. Out of 749.8 million roubles of deposits comprising the bulk of "other" deposits held with the State Bank (i.e., excluding the deposits of the Treasury) on April 1, 1928, there were (in millions of roubles):

Deposits and current accounts of State industry	171.0	m.r.
" " " " " transport	36.4	"
" " " " " State trade	16.3	"
" " " " " coöperatives	38.6	"
" " " " " private clients	24.0	"
" " " " " banks	64.1	"
" " " " " other organizations	375.2	"

As these figures show a great amount of the total of "other" deposits, held with the State Bank on April 1, 1928, was in respect of deposits and current accounts of the State enterprises, i.e., trusts, syndicates, etc. The current accounts of the coöperative societies showed a comparatively small figure, while

those of private persons were still less. Among the accounts of " other organizations " a considerable part is played by accounts of administrative and public institutions, including accounts of the savings banks, municipal services, etc., and accounts of insurance institutions, including those of the State insurance (Gosstrakh) and Social insurance.

The predominance of current accounts of State enterprises in the liabilities of the State Bank and the comparatively small place which is occupied by current accounts of private persons is a result of the specific conditions of Soviet economy. This is due to the fact that almost all the more or less important enterprises are concentrated in the hands of the State, while the small and medium-sized enterprises owned by private persons do not generally keep money at the banks, particularly at the State Bank. The latter circumstance, in its turn, is due to the fact that the State Bank in its asset operations, as we shall see further, does business chiefly with the large State and coöperative concerns and has little connection with private clients; moreover, another reason is that the rate of interest which the State Bank allows on current accounts is comparatively low.

We shall now attempt to total up the funds which the State Bank had at its disposal during the period under review. Discarding inter-branch accounts, which are merely bookkeeping entries between the Bank's institutions, and leaving out " special funds " of the People's Commissariat of Finance, sums derived by way of short-term foreign credits, and some small items of the liabilities, the principal funds at the disposal of the Bank for investing in its asset business will comprise three groups: the *Bank's own funds*, the *note issue*, and *deposits*. These three chief resources placed at the disposal of the State Bank the following sums (in millions of roubles, as of October 1 in each year):

	1/x 1923	1/x 1924	1/x 1925	1/x 1926	1/x 1927	1/iv 1928
Own Capital	80.1	124.2	153.1	157.5	325.7	365.6
Note Issue	235.0	521.9	756.6	856.8	1,026.6	941.8
Deposits and curr. accounts	142.8	308.1	737.4	800.8	1,378.4	1,647.8
Total	457.9	955.2	1,647.3	1,815.1	2,730.7	2,955.2

The total of the main resources of the State Bank can thus be approximately determined as follows:

Oct. 1, 1923	to	457.9	m.r.
" 1, 1924	"	955.2	"
" 1, 1925	"	1,647.3	"
" 1, 1926	"	1,815.1	"
" 1, 1927	"	2,730.7	"
Apr. 1, 1928	"	2,955.2	"

Asset Operations of the State Bank. We shall now turn to the asset operations of the State Bank, and see how the Bank invested these funds.

First of all it should be pointed out that in the movement of the State Bank's funds *two* drifts will be noticed, both of which are typical enough for a bank of issue in the initial stages of its development: namely, one part of the funds went to accumulating a stock of precious metals and foreign currency, and the other part to provide credit for various enterprises. In addition to this the State Bank invested a comparatively small portion of its funds in commodities (grain) and securities.

The bullion and foreign currency reserve of which the State Bank disposes is made up of three items:

(1) Precious metals;

(2) Foreign currency in bank notes and specie;

(3) Cash balances with foreign banks (under "Correspondents Nostro" account).

The bullion and foreign currency reserve of the State Bank on January 1, 1923, amounted to 27.9 million roubles, on October 1, 1923, it was 144.8 million, on October 1, 1924, 297.2 million, on October 1, 1925, 298.1 million, on October 1, 1926, 252.9 million roubles, on October 1, 1927, 299.9 million roubles and on April 1, 1928, 262.5 million roubles.

The State Bank's *credit operations* consisted of the discounting of bills and granting of various kinds of loans. From the table quoted above we can see that the Bank invested in these transactions: on October 1, 1924, 598.5 million; on October 1, 1925, 1,408.9 million; on October 1, 1926, 1,736.1 million and on October 1, 1927, 2,358.1 million roubles. On April 1, 1928, in these transactions were invested 2,822.2 million roubles.

If we add to these investments in the bullion and foreign currency reserve and credit operations the disbursements made by

the Bank in respect of its own commodities (chiefly grain) and securities, we would get the following picture of the Bank's total investments (in millions of roubles) as of October in each year:

	1/x–1924	1/x–1925	1/x–1926	1/x–1927	1/iv–1928
Bullion and foreign currency	297.2	298.1	253.4	299.9	262.5
Loans and discounts	598.5	1,408.9	1,736.1	2,358.1	2,822.2
Own commodities and securities	66.7	181.8	290.1	310.1	309.5
Total	962.4	1,888.8	2,279.6	2,968.1	3,394.2

On April 1, 1928, as we have seen, the chief volume of funds, amounting to over 2.8 milliard roubles, was invested by the State Bank in its discount and loan operations. Let us examine these operations more closely.

First of all we shall quote some data showing how these investments were distributed from the formal and technical side, that is, on what transactions these sums were paid out. The investments of the State Bank in separate discount and loan transactions were on April 1, 1928, as follows (in millions of roubles):

Bills and special account against bills	1,825.4
Loans and special accounts against goods and transport documents	326.3
Loans and special accounts against securities, foreign currency and precious metals	21.2
Special loans for industry	206.7
Financing of grain operations	292.2

The chief item is Bills. On April 1, 1928, they amounted to 1,825.4 million roubles, or 65% of the corresponding total.

An idea as to how the State Bank's credits were distributed among the various branches of national economy can be obtained from the data showing the indebtedness of the Bank's clients in respect to its discount and loan transactions.

The State Bank invested the chief volume of funds in enterprises of State industry (48.6% on October 1, 1926; and 52.8% on October 1, 1927); the next important of its customers were the credit institutions (13.9% and 13.8% respectively); thirdly the coöperative societies (13.9% and 12.7% respectively). The amount of credit granted by the State Bank to private persons and enterprises was comparatively insignificant.

The State Bank is, juridically speaking, a centralized credit institution controlled by a Board appointed by the Government, and carries out the bulk of its operations through the large network of its branches. Thus, on April 1, 1928, out of a total sum of 2.8 milliard roubles for discount and loan transactions, 1.7 milliard roubles figured on the accounts of the branches and 1.1 milliard roubles on the accounts of the Head Office. On February 1, 1928, the State Bank had altogether 570 branches, of which 32 are chief offices, 167 branches, and 371 smaller branch agencies.

THE CREDIT AND DISCOUNT POLICY OF THE STATE BANK. Having dealt with the general trend of development of the State Bank's operations, we shall now dwell on certain *aspects of its credit and discount policy.*

The *credit policy* of the State Bank, as the central institution of credit in the country, is of course determined primarily by the general principles of the Soviet Government's economic policy. In virtue of these principles the activities of the State Bank are directed chiefly towards supplying credit to State industry, State trade, transport, and the coöperatives and to credit institutions such as the Central Agricultural Bank, the All-Russian Coöperative Bank and others who, in their turn, employ the funds received from the State Bank for the financing of the same State and coöperative enterprises. At the same time, however, the State Bank in its credit policy is actuated by another principle, namely, its *endeavor to insure the utmost stability and liquidity of its assets* by investing its funds in such a way as would enable them to be moved about and transferred from one branch of industry to another or from one enterprise to another as seasonal or other changes may demand. The second principle is one which the State Bank is bound to reckon with, in so far as it is the center of credit in the country, and at the same time the central agency for the regulation of the currency. The correlation of these two principles is what determines the course of the State Bank's credit policy. The policy of creating most stable and liquid assets is exemplified, first of all, in the Bank's endeavors to select a clientele within the group of State and coöperative enterprises. A determining feature of this policy was the small amount of credit granted to the metallurgical industry up to 1924, and the inclu-

sion of individual enterprises out of this group in the bank's clientele as and when their business became profitable. Another manifestation of this policy was the granting of credits principally in the form of discount of short-term bills, etc.

Clientele of State Bank. It is interesting, however, to mention the following circumstance. Viewing the clientele of the State Bank from the point of view of the composition of the "corporations" which enjoy credit therein, it must be said that there is very little resemblance between them and the clientele of the old Russian joint-stock commercial banks. The main portion of the State Bank's clientele consists of State concerns, while a prominent position is also occupied by the coöperative concerns, i.e., clients which enjoyed very little credit with the old commercial banks. On the other hand the State Bank hardly affords any accommodation to private joint-stock companies, which formerly constituted the bulk of the commercial banks' customers. If we further compare the basic principles of the State Bank's policy with those of the old commercial banks, we shall find here again more dissimilarity than resemblance. Their common feature, in a degree, is their endeavor to insure the utmost security and liquidity of their assets. The private commercial banks, however, were alien to a broad national outlook in their business practices. On the other hand, the old private banks cultivated a different principle — a striving after profit, a principle which is not a determining factor in the State Bank's credit policy. But if we regard the clientele of the State Bank from the point of view of *their position in the country's economic life,* of the composition of the *economic units* or separate enterprises from which they are made up, it will appear that the State Bank is virtually supplying funds to the same *enterprises* which used to enjoy credit with the old private commercial banks. Thus the State Bank finances the same metal works, sugar-beet factories, tanneries, cotton mills, textile mills, railways, and so on, which were formerly catered for by the commercial banks. A new element in the State Bank's clientele is chiefly commercial concerns, various syndicates, coöperative, and state trading institutions which have replaced the former wholesale and large commission houses.

This fact has a double significance in the appraisal of the State Bank's investments. First, it shows that the composition of the

bank's borrowers is determined by the general condition of economy in the Soviet Union. The State Bank as the central institution of commercial credit discharging the larger part of the credit business, which before the revolution was carried on by the joint-stock commercial banks, must naturally base its activities on the clientele, which was always catered to in Russia by big commercial credit. It is its business to supply funds to large industrial enterprises, transport, big trade and to other credit institutions. Inasmuch as all these concerns are in the hands of the State and partly of the coöperative societies, the clientele of the State Bank naturally consists of State and coöperative enterprises. On the other hand, the composition of the State Bank's clientele furnishes an answer to the question of the security and liquidity of its investments. Since the clientele of the State Bank consists predominantly of the principal commercial, industrial, and transport enterprises, the quality of the bank's investments depends chiefly on the progress of these concerns, on the degree of financial soundness of the respective railways, syndicates, trusts, coöperative establishments, and credit institutions, etc., in which the State Bank invested over 2.5 milliard roubles at the beginning of 1928.

Discount Policy. As regards *discount policy,* the State Bank in the course of 1922 adhered to a system of high rates, regarding interest as one of the means of insuring capital against depreciation. In this period the State Bank's rate at one time reached 18% per month for advances calculated in paper currency; for advances calculated on a gold basis the bank applied in the same period the rate of 2% per month. With the transition to the chervonetz the State Bank began to lower the discount rate. From July 1, 1923, the rate of discount for short-term bills up to one month (of State organizations and coöperatives) was reduced to 8% per annum. From April 1, 1924, the State Bank again slightly reduced the discount rates. Finally, in March, 1927, the rate of discount of bills of State organizations and coöperatives up to 3 months was fixed at 8% per annum, and the rates for other loan operations from 8% to 10% per annum.

Furthermore, from March, 1927, the rates of interest which the State Bank allowed on current accounts is 6% per annum and on deposits 7–8%.

To appreciate properly the discount policy of the State Bank it should be borne in mind that under the economic conditions prevailing in the Soviet Union where the State holds a position of monopoly, owns big industries, regulates the prices of its own manufactures and wields a monopoly over foreign trade, the *discount rate of the central bank cannot aspire to the rôle of a regulator of the supply and demand of loan capital.* The volume of the demands for credit which are tendered to the State Bank by the State trusts, syndicates, and coöperative organizations, etc., under present conditions would hardly be affected if the State Bank were to charge a few per cent more or less than the present rates of 8–10% for the advances which it makes. Hence, the State Bank in fixing the discount rate is not prompted by any motives for using this as a medium to regulate the supply and demand of loan funds, but does so merely with a view to reducing as much as possible the cost of credit as a factor likely to influence the calculation of the cost price of commodities. The rate of interest which the State Bank pays on deposits and charges on its asset transactions could not therefore be regarded as the "market" price of loan funds. This price on the whole, taking into consideration the state of the money market, is admittedly low. It it not difficult therefore to see that the State Bank is enabled to give credit at a comparatively low rate because its resources consist to a large degree of note issue and of funds of the Treasury for which it pays no interest.

This peculiar character of the State Bank's discount rate is reflected in the fact that side by side with this "official" discount there exists in the U.S.S.R. a private discount rate of quite a different kind. In a report which the writer had occasion to deliver in June 1925 on the subject of the State Bank's discount policy he described the state of the money market in the U.S.S.R. as follows: "We have in fact in the U.S.S.R. not one but three different money markets, each of which has its own separate existence. The first money market is the one which is founded on the State Bank's credit. Here the price of money is from 8–10%. The rate of 11% per annum on this market is considered a dear one. In the vicinity of and alongside this market are operating certain other credit institutions, although they . . . swing over to another market where money costs 18% and where a rate of

12–14% is considered cheap. Besides this credit market which is supported by the State Bank's credit, we have another one — the market of State securities and short-term bonds, of the lottery loan, etc. This market has quite another discount rate. Here money is procurable, neither at 8% nor at 9%, but at 16 to 18% per annum, which is considered a normal rate for this market. Finally there is a third market, the private market. It is associated with the activities of the Mutual Credit societies, which are its cheapest part. There money costs 36%, and sometimes more per annum. This market terminates with private discount. Discount there is 6 to 7% per month.[13] To appreciate the situation one must be mindful of the fact that the relative rôle of all three markets are not alike. The private market is not as large in volume as the market which is based on the State Bank's credit. It will be sufficient to point out that the investments of all the Mutual Credit societies in loan and discount business on January 1, 1928, amounted to 30.1 million roubles; this comprised only 1.5% of the corresponding investments of the State Bank, which showed on the same date 2,560 million roubles. Nevertheless, the fact that these three markets are dissociated, and the large diversity of percentage rates illustrates the peculiar significance of the State Bank's discount rate. We must say, indeed, that in the last years the rates of the State loans are somewhat lower. These loans, issued during the years 1927–1928, give an income of about 13–14% per annum to the holders of the respective bonds. Therefore, in the year 1928, the margin between the two first parts of the money market has become much narrower.

Planning of Credit. It will not be difficult to gather from what has been said above that the market factors of supply and demand of loan funds do not exercise any essential influence on the line of the State Bank's credit policy. As far as the State Bank is concerned the discount rate is neither an index of the supply and demand of loan funds nor a regulator of such supply. Under these circumstances the State Bank is guided by another principle in regard to the investment of its inflowing funds, namely the *allocation of funds among financially sound credit*

[13] At the second All-Union Conference of Local Managers of the State Bank.

aspirants in accordance with a definite plan. At times when the demands for credit exceed the State Bank's available resources — as was the case with rare exceptions almost throughout the five years from 1923 to 1927 — the State Bank is obliged to divide these funds in some definite way among the enterprises which have need of them. The policy of distributing funds systematically among the enterprises demanding credit, materialized in the form of quarterly *credit programs* after 1923–1924. The State Bank on the eve of each quarter frames an approximate program of its activities for the given period, computes the resources which it contemplates receiving during that quarter, and in dependence on seasonal and actual demands allocates credits to one or another branch of industry. Since the State Bank's customers are invariably interested in knowing in advance exactly what credit they can count on for a certain period of time, the credit programs of the State Bank, and lately of other banks as well, are arranged by the banks with the institutions concerned, such as the Supreme Council of National Economy, the State Planning Committee, etc. The credit programs during 1923–1927, however, merely served the State Bank as a guiding scheme, since it was frequently compelled in practice to depart from it in one or another degree, in cases when its resources from deposits and current accounts proved to be greater or less than the sums estimated for in the programs.

CHAPTER XIV

THE BANKING SYSTEM OF SOUTH AFRICA

BY

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But the authors alone hold themselves responsible for the contents of the chapter, each for his own sections, especially as regards criticisms and conclusions.

BRIEF HISTORY OF THE SOUTH AFRICAN MONETARY SYSTEM

Readers are reminded that " South Africa " refers to the Union of South Africa, which consists of the four provinces, the Cape, Natal, Orange Free State, and the Transvaal. The *Cape* was a Dutch possession from 1652 to 1806, except for the British occupation from 1795 to 1803. Since 1806 it has been a British possession. *Natal* was a Boer Republic from 1839 until May 10, 1843, when it was proclaimed a British possession, which it has remained ever since. The *Orange Free State* was a Boer Republic from 1854

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until the end of the Boer War in 1902. The *Transvaal*, except for the period of the British occupation from 1877 to 1881, was also a Boer Republic from 1852 until 1902, and was known during that period as "The South African Republic." From 1902 to 1906 both the Transvaal and the Orange Free State (known during this period as the Orange River Colony) were under Crown Colony Government and finally in 1910 the Union of South Africa was formed.

THE CAPE. Until 1680, the monetary unit of the Cape had been the Spanish real or the "real of eights," but then it was replaced by its equivalent, the ryksdaalder (rixdollar) as the unit of account. The Dutch and silver coins in circulation at the Cape were soon supplemented by a heterogeneous collection of foreign gold and silver coins, chief of which was naturally the Spanish dollar, which were introduced by the ships making the Cape their point of call going to and from the East. Accordingly tariffs had to be published from time to time fixing the relative values of the various coins. But when, as a result of the American War of Independence, the Cape was completely cut off from Holland, it was found necessary to authorize the issue of inconvertible paper money for the first time in the history of South Africa by a proclamation of May 31, 1782. After the war, the greater portion was redeemed, only to be followed up subsequently by further issues. Thus in 1795, on the surrender to the British, the paper money in circulation amounted to 1,291,275 Rds.; at the time of the retrocession in 1803, to 1,786,275 Rds.; and at the time of the final surrender in 1806, to 2,086,000 Rds. Further issues, amounting to 1,000,000 Rds., were made between 1810 and 1814. The value of the rixdollar had in the meantime rapidly depreciated. It had declined from 4 shillings and 2 pence, reaching 1 shilling and 6 pence in 1825, at which rate its value was fixed in that year when sterling was at last introduced. In 1881, the British Coinage Act of 1870 was applied in its entirety to the Cape.

NATAL. Natal was fortunate enough to be spared all the undesirable experiences of an inconvertible paper circulation, and in 1882 the British Coinage Act of 1870 was similarly applied to this colony.

THE ORANGE FREE STATE. Through the establishment of its first

bank in 1862, sterling money was introduced into the Free State. Two issues of £30,000 and £100,000 of " blue backs " had to be made in 1865 and 1866 respectively, and were redeemed in due course. Efforts to have the Transvaal coinage declared legal tender a few years previous to the Boer War were unsuccessful, whereas British sterling had come to be accepted as legal tender throughout the Republic without any legislative intervention. In 1900 the British authorities declared the Transvaal coins legal tender in the Free State.

The Transvaal. This Republic for many years existed practically exclusively upon the issues of paper money. Issues of £12,000, £20,000 and £45,000 of " blue backs " had been authorized in 1866, 1867, and 1868, respectively — thus £77,000 in all. But in 1870 it was found that an amount of over £79,000 had been issued, of which £73,826 were still in circulation. In 1873, the Republic rid itself of its paper money, a loan of £63,000 having been obtained. As a result of the development of the goldfields, a concession for the establishment of a Mint was granted in 1890, followed up by the passing of the Mint Law No. 14 of 1891, by which a coinage system practically identical with the British law was definitely adopted. In 1893, a Mint Conference was held at Pretoria to which representatives of the other three States had been invited. Unfortunately no agreement could be arrived at for the conversion of the Pretoria Mint into a South African Mint. Hence, until the Republic ceased to exist, when the Mint was also closed, " Kruger coins " were legal tender only in the Transvaal.[3]

After the Boer War. Such was the state of affairs until the end of the Boer War. By an ordinance of 1904, both the Kruger coins and sterling were declared legal tender in the Transvaal.

[3] During its existence the Mint struck: —

	No. of Pieces	Value
Gold..............	2,565,264	£2,383,771 10/–
Silver.............	5,375,428	336,761 11/6
Copper............	356,242	1,484 6/10
Total.............	8,296,934	£2,722,027 8/4

But in 1906 the Coinage Act of 1870 and its amendment of 1891 were applied to the Transvaal, and in addition Kruger coins were declared legal tender up to the same amount as coins of the Royal Mint in the Transvaal including "the dependencies of that Colony." After the establishment of the Union of South Africa (1910), the British Coinage Act was applied to the whole Union in 1911, and Kruger coins were similarly declared legal tender throughout the Union. It was not until 1919 that the necessary steps were taken to provide South Africa with its own Mint again. By the Pretoria Mint Act of 1919, a branch of the Royal Mint was established, which commenced operations in January, 1923.[4]

Bank Note Issues. In accordance with the Banking and Currency Act of 1920, the Reserve Bank assumed the note issue monopoly on June 30, 1922. Up to that time this privilege had been enjoyed by all the banks in the country subject only to different regulations in the four provinces.

In Natal, the only general banking legislation in existence was the Bank Statements Law of 1881, in accordance with which separate statements for each branch bank in Natal had to be published regularly until the law was repealed by the Bank Act of 1917. But for the rest, there was no general law affecting the banks. With the exception of a few small banks which failed shortly after 1862, the only Natal banking institution was the Natal Bank established in 1854. Since it was established by Act of Legislature, provision was made, in this instance only, for the issue of notes of not less than £1.

[4] The output of the Pretoria Mint between January 1, 1923, and December 31, 1926, was as follows: —

Gold Coin	£17,692,704
Silver Coin	984,301– 7–6
Bronze Coin	3,241–14–2¾
Total	£18,680,247– 1–8¾

During this period, British silver coin to the amount of £502,200 was exported and £821,763–11–6 withdrawn by the Pretoria Mint. In addition £120,139–6–3 in old Transvaal silver coins and £55,555 of German silver coins (from the mandated territory formerly known as German South West Africa) were withdrawn by the Mint. It is estimated that, even with the inclusion of imports, a reduction of £388,008–0–3 has been brought about in the amount of silver coin in circulation.

In the Transvaal, the operations of all banks were regulated by Law No. 2 of 1893. No notes for less than one pound could be issued and a one-third reserve in legal coin was required against note issues, and assets in the Transvaal for the balance. The notes were not, however, to be accepted in payment at Government offices though they were payable in gold coin on demand at the appropriate offices of the issuing banks.

The Orange Free State in contrast with the Transvaal fixed no minimum nor maximum amounts for bank notes in its ordinance No. 20 of 1902. All that was required in this instance was that the notes should be payable at the banks' chief offices in the Free State in gold without deduction of any percentage or charge. Further, the specie at both the chief office and branch offices of each bank in the Free State should together not be less than one-third of the amount of the notes in circulation of such bank.

Rigid Control. The Cape, as a result of its sad experiences of bank failures, especially in 1890, resorted to a more rigid control of the note issues of its banks in the Cape Bank Act of 1891. This was modeled upon the United States National Bank Act as far as note issue was concerned. Accordingly we find that notes of the denominations of £20, £10, £5, and £1 only could be issued to the banks by the Government Treasury upon the deposit of government securities. No bank could issue notes to an amount exceeding its paid-up capital and reserves and, in case of default, the Government could sell the securities it held and redeem the notes of such defaulting bank. In addition, it had a first lien on all the assets of the bank until redemption was secured. Finally, in contrast with the notes of the other provinces, these notes were legal tender, being generally known as Cape Legal Tender Notes.

Thus on December 31, 1913, we find the following amounts of notes outstanding for all the banks in the Union: —

	December 31, 1913
Legal tender notes (Cape)	£1,137,000
Other notes	1,167,000
	£2,304,000

As for *deposit currency,* however, no regulations existed in any of the four provinces and not until the passing of the Banking

and Currency Act of 1920 were banks required to maintain reserves against deposits.

The currency history of South Africa since 1914 has been very similar in essentials to that of most of the belligerents — the history of an embargo, inflation culminating in the boom of 1919–20, crisis, the abandonment of specie payments, depression and a painful period of reconstruction and restriction towards the goal of convertibility and stability finally attained in 1925.

Fundamentals of the Situation. To understand what happened to our currency during the war and immediately after it is necessary to bear the following facts in mind: —

(1) For historical reasons the Union has been closely connected with Great Britain for very many years; by far the greater proportion of her trade is with Great Britain; most of her capital requirements have been either supplied by or through Great Britain; the units of currency, the pound sterling, are the same (i.e. when the gold standard is in operation); her gold and silver currency was minted in and supplied from London; rates of exchange between South Africa and other countries were quoted via London, the latter therefore being the only rate quoted, expressed as a certain per cent premium or discount.[5]

(2) Early in the war the South African banks made an arrangement not to have a rate of exchange dependent upon the equation of international indebtedness, but an artificial rate by which a remittance fee (wider than the pre-war gold points — $\frac{7}{8}$ per cent as compared with $\frac{1}{2}$ per cent) was charged for exchange each way. *This linked them entirely to the British exchange* (an advantage in some ways in that the pegging of the sterling-dollar exchange by the British Government during the war gave the Union similar advantages; but the disadvantages appeared later).

The European crisis produced no immediate adverse reactions in South Africa. The Union Government, indeed, took prompt steps to assure the public as to the soundness of the financial position, and a notice was issued by the Treasury at Pretoria on August 3, 1914, from which the following significant extracts are taken: —

[5] This antiquated method of quoting exchange rates is still adopted by the banks.

"The Government has had under consideration the probable effects of the present European crisis on financial dispositions within the Union. The Government can see *nothing in the present situation which demands the introduction of radical measures,* nor does there seem to be any need for restricting banking or other financial facilities. The Government is carefully watching developments and will take every precaution for *preserving and safeguarding financial stability within the Union.*"

Early Precautionary Measures. Immediately it was known that war had definitely broken out in Europe, the Government called a conference of bankers, mining houses and merchants, and, following this consultation, negotiations were completed between the Bank of England and the Union Government by which it was arranged that the Bank of England on behalf of the British Government should take over the whole output of the South African Mines (at the usual price), the banks advancing the gold mining companies in South Africa against the delivery of their raw gold deposited with the Union Government, and, in return, obtaining from the Bank of England in London the equivalent, thus removing a difficulty which was causing anxiety, not only in South Africa, but also in London.

On August 8, it was announced (though it was never actually put into effect for the necessary legislative steps were not taken), that the old Pretoria Mint would be re-opened temporarily for the coining of sovereigns and half-sovereigns; and because of the slight disorganization of the country's export trade, the Union Government, again after consultation with the banks, completed a scheme (slightly altered later on) whereby cash advances could be obtained against deposits of wool, mohair, skins, and hides produced in the Union up to 50 per cent of the certified value of the produce deposited, the produce warrants being transferable by indorsement and delivery. Following the English example, a Public Welfare and Moratorium Act was passed on September 15, 1914, which conferred very wide powers on the Governor-General, these powers to be exercised by Proclamation.

Currency Act of 1914. The above measures can be justified;

but, despite the Treasury notice of August 3, *radical measures* were then introduced. By the Currency Act, 1914 (passed September 15), to "provide for the protection of the Currency," notes already issued by the banks could be *by proclamation* declared legal tender throughout the Union, and if necessary further notes, also legal tender, could be issued against the deposit of securities with the Minister of Finance, such notes to be convertible, though it was stipulated that the banks need hold no specie reserve against them! The Act was to be put into force by proclamation: no such proclamation was ever issued and the Act (by § 11) therefore ceased to be of any force or effect on June 30, 1915. While *legally* therefore it had no effect and note issues continued to be governed by the very lax pre-war legislation, at the same time it cannot be absolved from all blame for the inflationary period which followed, for by disclosing the line the Government was likely to take in an emergency, it made the banks less careful and discriminating. It was, indeed, an unnecessary piece of panic legislation, and if its technical effect was negligible, its moral effect seems to have been undoubtedly great and the Government's "monetary lapse in 1914" was to be attended with serious consequences later on.

The Embargo. The first really important financial step was taken on November 6, 1914, when by Proclamation 243, issued under the provisions of the Public Welfare and Moratorium Act, the exportation of "gold and silver in coin or bullion and paper money" was prohibited to "foreign ports in Europe and to non-European ports in the Mediterranean and Black Seas with the exception of French, Spanish, and Portuguese ports and Russian ports, other than those on the Baltic Sea." The embargo was imposed "as a military measure" and partly perhaps from sentimental reasons through the Union's connection with Great Britain: it was claimed, too, that "its imposition was inevitable." Though it is easy to be wise after the event, it is sufficiently doubtful whether adequate cause existed for it at the time and it certainly could not have been realized how serious a step was being taken, for in effect the proclamation abolished the gold standard in the biggest gold-producing country in the world. Though the terms of the embargo were altered from time to time and made more stringent, it never was and never could be very

effective because South Africa's dealings with the outside world are very difficult for a Government to control, "partly because the Union is not an island and partly because two sections of the population — Natives and Indians — do not belong to the governing democracy and also have connections with the outside. Consequently extensive smuggling out of coin was possible and was sure to take place if made profitable." Indeed it is worth noting that, apparently through a Government mistake, no embargo existed at all for a short period (from August 11, 1916, to December 15, 1916)!

Increase in Notes and Advances. Relieved by the embargo of the necessity of providing specie for export, though their notes were still convertible, and imbued with the "laudable" ideal of "conserving and economizing the gold in the Union," the banks immediately began to increase their note issues and at the same time to extend their advances. Illegal issues of ten-shilling notes even took place in the Transvaal, though such denominations were legalized both there and in the Cape by the Bank Act of 1917.

Ten-shilling notes were also issued in Natal and in the Orange Free State. Having regard to legislation in the Transvaal and the Cape it was perhaps going too far to conclude that, because the laws of Natal and the Orange Free State did not expressly forbid the issue of notes below one pound, such notes could be issued. The Natal Bank Law (No. 43 of 1888) definitely forbade that bank to issue notes for less than one pound in value and a similar regulation had applied to the note-issuing privileges of the defunct National Bank of the Orange Free State Ltd., (amalgamated in 1910 with the National Bank of South Africa Ltd.).

The increase in their note circulation and in the totals of their advances and deposits was naturally accomplished by a steady increase in the index figure of wholesale prices and the cost of living as the table on p. 964 shows.

Trade Situation. At the same time the trade situation to a certain extent and Government expenditure to a lesser extent accounted for some of the increase in the circulating media. The prices of imported goods from Great Britain showed steady increases throughout the war and this combined with the fact that

Year ending Dec. 31	Deposits (Time and Demand)	Bills Discounted and Advances	Notes in Circulation (Legal Tender & Other)	Coin in the Banks' Coffers	Proportion of Coin to Deposit Liabilities	Index Numbers of Wholesale Prices
	£1000	£1000	£1000	£1000	%	1910 = 1000
1913.....	44,874	41,968	2,304	8,150	18.1	1,125
1914.....	45,397	41,303	2,404	8,372	18.4	1,090
1915.....	51,088	41,323	2,732	9,151	17.9	1,204
1916.....	55,286	48,276	3,432	6,961	12.5	1,379
1917.....	64,772	48,121	4,658	8,939	13.8	1,583
1918.....	77,593	62,508	6,451	9,337	12.03	1,723

exchange was linked to sterling, called for increased bank advances to South African importers (the increase in the prices of imported goods right throughout showing a close correspondence with English wholesale prices). Moreover, as the war progressed, the increased restrictions on trade, the decrease in shipping facilities and the increase in freights, together with difficulties of manufacture in foreign countries, made importations difficult and led to the establishment of a large number of South African industries which the banks again were increasingly called on to finance. Nevertheless, when due allowance has been made for these factors, considerable inflation and over trading on the part of the banks (with the exception of the Netherlands Bank of South Africa) took place even though their power to grant advances was somewhat limited by the need for paying out gold occasionally for internal demands and therefore for importing specie from London, though, if they had been very anxious to maintain their reserves, they could, with the Bank of England's permission, have held gold bullion.

Increase in Cost of Living. The continued increase in the cost of living was responsible for considerable unrest in the country and the Government endeavored in vain to keep down prices by legislative action, by the appointment of Cost of Living Commissions and by other means. Moreover, the export trade of the Union increased enormously, the total exports being in 1913 — £66,659,552; 1914 — £40,223,283; 1915 — £35,012,365; 1916 — £65,870,473; 1917 — £91,728,140; 1918 — £70,855,877; 1919 — £106,450,873, with the result that the banks accumulated large

balances in London which they could not bring back to the Union.

The Trade Boom. The movement culminated, as in other countries, in the inflationary period and the speculative post-war boom of 1919–20 for which the banks were undoubtedly largely responsible. In 1918 notes totaled £6,451,000; 1919 — £8,220,000; 1920 — £9,469,000. Advances at the same time reached £62,508,000 in 1918; £81,655,000 in 1919; and £91,139,000 in 1920, the corresponding figures for deposits being £77,593,000, £107,076,000, and £102,332,000; the index number of wholesale prices being 1918 — 1723, 1919 — 1824, and 1920 — 2512, and the cash reserves of the banks against notes and deposits had fallen to 8.08 per cent in 1919, but rose to 11.8 per cent at the end of 1920.

Parity with Sterling. The English paper pound had long been inconvertible, but had been maintained practically at parity with the dollar by "pegging" the exchange (4.76 dollars to the pound as compared with 4.866) and as South African exchange was linked to sterling exchange and all South African bank notes were legally convertible into gold, the South African pound was a gold pound at par with the English paper pound. With the unpegging of sterling exchange in the middle of 1919 the rate of exchange was allowed to follow its natural course and there was an inevitable decline in sterling showing a corresponding depreciation of the English pound, i.e., there was a premium on gold in terms of the English pound which reached finally 50 per cent on February 5, 1920, when the price in London of a fine ounce of gold was 127s. 4d. as compared with the pre-war standard rate of 85s. On and after July 25, 1919, the South African gold producers were given a free gold market for their product in London.

Throughout 1919 the banks were agitating for the Government to issue a proclamation making their notes inconvertible, for during all this time, owing to the continuous depreciation of paper due to its over-issue, the banks had been increasingly called on to honor their promises to pay and the sovereigns thus obtained were smuggled abroad and sold for more than the foreign currency equivalent of a South African pound. In other words, the penalty which they had to pay for issuing too much paper was

that they had to buy sovereigns in London at 26s. or 28s. and pay them out in the Union at par.

THE EXCHANGE POSITION. The exchange position was also affected. Despite the high premium on gold and the fact that notes in circulation in the Union were convertible, the banks still quoted exchange in London as though English currency were on a parity with gold when in fact it was (March, 1920) depreciated to the extent of about 22½ per cent as evidenced by the New York-London exchange. Their quotations, therefore, operated as a handicap on the importers and raised the cost of living, that is, commodity prices in South Africa as regards imported goods, to the extent of the difference, namely, 22½ minus 7½ per cent, though 8 per cent was the highest rate quoted (May 1 to June 14, 1920). Exporters on the other hand obtained a corresponding premium. In other words, the policy of the banks either deliberately or through ignorance was such as to make the South African pound fluctuate in accord with changes in the English; and since England's currency was undergoing at this time (1919–1920) the process of rapid post-war inflation, the continued inflation in South Africa was masked by the approximate equivalence in the exchange rate. Moreover, wages and general costs in the gold-mining industry having increased considerably in paper money, it looked as though the interests of the mining industry lay in a continuance of the gold premium, though this shortsighted view was strongly combated by Mr. (now Dr.) Samuel Evans, Chairman and Managing-Director of the Crown Mines. Gold coins naturally disappeared by smuggling, hoarding, and illicit exportation and the pressure on the banks, coupled with their already depleted cash reserves, constituted a dangerous situation.

SELECT COMMITTEE OF 1920 AND THE CENTRAL RESERVE BANK. As a result of their continued agitation, following two currency conferences, held in October, 1919, a Select Committee of the House of Assembly was appointed in March, 1920, to investigate the effects of the embargo on the export of specie upon the cost of living, and whether the statutory provisions in force in regard to currency and banking should be modified. The constitution of the Committee was far from ideal, and it was completely dominated by Mr. (now Sir) Henry Strakosch, an able

witness, but one whose evidence was full of inaccuracies and inconsistencies.

> "The Committee never seriously considered the real practical issue which should have been put to it — whether it was best for South Africa to keep her currency level with gold or level with the British paper pound." (Cannan).

The Committee practically accepted the whole of his recommendations, and as a result of its Report, issued in June, 1920, the Currency and Banking Act, No. 31, of 1920, was passed, and came into operation on December 17, 1920. The embargo was continued, the notes of the banks were declared inconvertible (prior to their complete retirement), gold certificates (which were declared inconvertible until June 30, 1923, and of which £10,445,901 were finally issued and all withdrawn since May 18, 1925) were to be issued against gold deposited with the Treasury, and a Central Bank, known as the South African Reserve Bank, was established which opened on June 30, 1921, for the purpose of consolidating the note issue and controlling the currency of the Union. The organization and functions of the bank are discussed in detail in the section on banking.

THE PERIOD OF INCONVERTIBILITY AND DEFLATION. The boom, as in other countries, was followed by a period of deflation and restriction with the avowed object of returning to the gold standard at the pre-war parity and 1920 saw an adverse trade balance of £6,929,821 for the first time and the rate on London swung round finally to $4\frac{1}{2}$ per cent premium (November 30). Unfortunately the banks appear to have reduced facilities in some cases with as much haste and as little discrimination as they had earlier granted advances, and to have greatly contributed to the resulting depression, which was interrupted by the Rebellion on the Rand in July, 1922. The appreciation of sterling assisted the movement somewhat and in March, 1923, the South African pound was within 3 per cent of gold parity, but for entirely inadequate reasons, as a result of the passing of the Currency and Banking Amendment Act, No. 22, of 1923 (which made some important alterations to the 1920 Act), following the recommendations of a Currency Conference held in October, 1921, and a Select Com-

mittee of the House of Assembly held in March–April, 1923, this opportunity was not grasped, and the period of inconvertibility was extended to June 30, 1925.

THE GOLD STANDARD INQUIRY. The South African pound steadily approached parity and in October, 1924, a Commission consisting of Dr. E. W. Kemmerer of Princeton University and Dr. G. Vissering, President of the Netherlands Bank, was appointed to decide whether this period should or should not be further extended. Their Report, an extremely able and well argued document, was issued in January, 1925, and presented in convincing fashion the case for South Africa's return to the gold standard. After thoroughly analyzing the position (particularly with reference to the new Mint and the Reserve Bank) the Commissioners pointed out that on January 3, 1925, the South African pound was actually 0.86 per cent above gold parity and recommended the Government " to clinch gold parity while it is here and, to that end, to announce to the public at the earliest possible moment the intention of the Government to let existing legislation stand and to return definitely to the gold standard July 1, next."

The Report was dated January 8, 1925, and on the 12th the Minister of Finance, Mr. N. C. Havenga, issued a Treasury notice which stated *inter alia:*

> " The Government has decided that it will not introduce legislation postponing the resumption of gold payments beyond June 30, next. Specie payments will accordingly be resumed on July 1, *or such earlier date as may be necessary under existing legislation.*" (Author's italics).

The Reserve Bank bought gold from the gold mines from January 25 onwards *at less than par* and therefore in terms of the Currency and Banking Act, Chapter I, S. 7(1) and (1)(a) and in view of the above notice, the *Union could and should have reverted to gold immediately* by rescinding the Proclamation suspending gold payments issued under the above section: for the " market price of gold in the Union did not exceed three pounds, seventeen shillings, and tenpence halfpenny per standard ounce."

The Minister, however, declined to alter the date determined

on, claiming in the House of Assembly on March 29 that "the resumption of specie payments on July 1, next, *and not sooner*, has the support of Doctors Kemmerer and Vissering." This was clearly a mistake, for Section 19 of their report reads: "At the time of writing (January 3, 1925) the banks' T.T. rate on London is, and has been for over two months, approximately 0.86 per cent above gold parity and if a rate as favorable as this continues long, South Africa may find itself practically back on a gold standard with gold coin in circulation *long before 1st July.*" A "golden" opportunity, that of being actually the first, was therefore missed.

Months before July 1, however, the situation foreshadowed in Section 16 of the Report arose. The concluding sentence of that section was:

> "It is sufficient to say if sterling returns to parity by July 1 next, South Africa's problem will have been largely solved."

Great Britain (her hand undoubtedly forced by South Africa's expressed intention) reverted to a modified form of the gold standard on May 11, followed by the other Dominions and Holland, and on May 18 the Minister of Finance stated in the House of Assembly that owing to changed conditions, the Union would revert to gold forthwith, and from that date the movement of gold has been freed from all restrictions.

THE CREDIT SYSTEM

The credit system can best be considered under the following heads: —

Commercial and banking credit instruments with relation to: —

(1) Internal Trade.
(2) External Trade.

Investment credit instruments and bankers' securities.

(1) Internal Trade. It must be emphasized that for historical reasons a large proportion of the internal trade of South

Africa is unfortunately on open account, though the practice is universally condemned. Many large firms, especially in Natal, will neither give nor accept bills, and one large Cape Town merchant stated in 1920 that in his own business the proportion of bills to outstandings was only 5.8 per cent. The evils of the system of open trade credit are apparent and since its inception the South African Reserve Bank has endeavored to get business more on a bill basis, but with limited success. It was because of this system, and the consequent lack of suitable high-grade commercial paper for rediscounting, that in 1923 the Reserve Bank, by the Currency Amendment Act, was given power to utilize short-date Treasury Bills, both of the Union and of the Imperial Government.

(a) Unless transactions are on open account the movement of goods internally from wholesaler to retailer is financed largely by *bills* for collection. Bills of Exchange (including checks) are in form identical with those of the United Kingdom. Each province in South Africa has its separate Bills of Exchange Act, but all these are based on and closely follow, though they are not precisely identical with, the English Act of 1882, differing from it only in minor details. The above documents are all negotiable instruments in the broad legal sense of the term. Bills may be given to the bank purely for collection purposes, or the wholesaler may — and frequently does — discount such bills with his bankers. In either case the banks are the intermediaries for collection purposes.

With regard to movements of produce, especially from up-country to the coast ports with a view to subsequent export, the usual procedure may be illustrated by considering South Africa's two principal agricultural commodities: wool and maize.

The ordinary procedure with regard to wool is for the wool merchant at the coast (whether he is buying wool outright or merely selling on a commission basis) to establish through his bankers a letter of credit authorizing the up-country dealer to draw on him at sight, 30 or 60 days, for wool forwarded, a common stipulation being, in the case of consignments, that he draws for only 75 per cent of the invoice value; the invoice and the rail note are attached to the draft which the producer takes to his banker at the up-country center, and the latter purchases it if

it is duly drawn in terms of the credit. The merchant at the coast, after selling the wool, in due course settles with his up-country client for the difference. A similar procedure is adopted with regard to hides, skins, mohair, etc.

(b) During 1923 and 1924 grain elevators were established at different points throughout the country by the South African Railways and Harbors. These authorities issue to the farmer (or other owner) *receipts* for grain deposited in the elevator, and the holder of this receipt obtains thereby a right against the Railways to have the same quantity of grain of the same quality delivered to him at any other elevator in the country on payment of the necessary charges for railage and storage. This receipt is transferable, and is frequently used by the farmer in obtaining credit from the banks against his maize. It may be completed and pledged to the bank against advances or it may be attached to a draft drawn on a grain merchant either at the coast or elsewhere, and the draft discounted with the farmer's bankers. The receipts are accordingly transferable, but are not, in the strict legal sense of the term, "negotiable." The provision of elevators and elevator receipts has greatly benefited the farmer, as he is not now compelled to sell his produce immediately, but can obtain an advance against the receipt and hold the grain, if desired, until a more suitable period — though this has a tendency to encourage speculation on his part.

(2) External Trade. The major portion of the external trade of the country is naturally financed by means of *bills of exchange,* and these for the most part are drawn under letters of credit established by the importer through his bankers. Many of the local buyers are merely authorized representatives of large overseas merchants or manufacturers, though there are also a few large South African merchant houses which take an important part in the export trade.

Occasionally these letters of credit, especially those established for export of South African goods, embody what is known as the anticipatory overdraft clause. This enables the accreditee to obtain advances from his banker to a defined extent in order to enable him to have working cash for expenses and to a certain extent for purchases. Anticipatory overdrafts may be of two kinds: (1) clean, (2) secured. Under the former the banker

merely honors checks of his customers to the extent named, but he has no means of ascertaining if the payments are in respect of produce actually purchased with a view to shipment in terms of the credit, while under the latter he is empowered to honor his checks only if security has been deposited against the anticipatory overdraft as required by the relative clause in the letter of credit. Where produce is so pledged — and for such pledge it is essential that the produce be in the hands of a third party who holds it subject entirely to the order of the bank — the bank, immediately prior to shipment, instructs the holder to release the produce and sees that, in the course of a day or two, a bill of exchange is drawn under the credit to which is attached a bill of lading covering the produce. The bill, of course, is then purchased by the bank, and the proceeds go in reduction of the anticipatory overdraft.

Imports from Australia and the East generally are financed by letters of credit established by the importer in this country, and payment of the subsequent drafts is made in London.

INVESTMENT CREDIT INSTRUMENTS AND BANKERS' SECURITIES

I. Bonds of various kinds, as detailed below, fall under this heading as a considerable number of private individuals, building societies and other associations invest funds in mortgage bonds over agricultural and other properties. Similar bonds, however, are frequently used in order to obtain credit from banks. *Bonds* taken by banks may be of the following kinds: —

(1) A covering mortgage bond over immovable property.
(2) A special bond over movable assets.
(3) A general bond.

(1) A covering mortgage over immovables is effected by means of a written contract, known as a bond, which must be executed before the Registrar of Deeds, and registered against the title deeds of the property. The bond must be prepared either in the office of the Registrar or by a conveyancer. The usual practice is for the debtor to grant a

power of attorney in favor of a conveyancer, authorizing him to appear before the Registrar and execute the bond. The power sets out all the terms and conditions of the bond.

(2) A special bond over immovable assets must be executed before a notary and registered in the office of the Registrar of Deeds.

(3) A general mortgage of all the debtor's property of every description is constituted by means of a bond, known as a general bond, which must be executed before a notary and two witnesses and registered by the Registrar of Deeds. It is well to remember that, under Roman Dutch law (which is the Common law of South Africa), the only really satisfactory method of obtaining a charge on movable property is by way of pledge which, to be valid, entails complete possession or at least control of the assets by the creditor. As possession or control is not always practicable (e.g., machinery used in a business), the general bond is taken as an alternative but it is not now a gilt-edged security as, in fact, the law frowns upon such charges.

Mortgage bonds may be ceded. An ordinary mortgage for a specific loan confers absolute security upon the person who acquires the bond; a covering bond passed to secure fluctuating facilities secures only the amount due at date of the cession.

The great majority of bonds taken by banks are covering bonds, i.e., bonds which cover fluctuating advances. The distinctive feature of such a bond, whether it is special or general and whether over movable or immovable property, is in the debt itself. The bond is given in advance to cover a liability which may be incurred only in the future, and such a bond consequently is of special use in providing cover for fluctuating facilities. It is important to note that, in order to safeguard the rights of a creditor making advances under such a bond, the preference conferred by the bond dates not from the day on which the advance is made but from the date of registration. Bonds of this nature are frequently taken by the banks not only from farmers but over town property where it is desired to have good security against advances.

II. Other credit instruments frequently used to secure bank advances are: —

(1) Personal guarantees. These, which follow a well recognized form, are used to a great extent especially in country districts, but they are not negotiable and cannot be ceded.

(2) Pledge (already mentioned), the form of which has been evolved from years of experience, may be of three types: it may be a pledge of

(a) shares or stock;
(b) merchandise or produce;
(c) bills for collection.

Pledges are not negotiable; neither are they security to anybody who takes them.

(3) Cessions of Right. These are of many forms, but all are really cessions of debt or of claims due on business transactions. They are not negotiable.

III. Other investment instruments available in South Africa comprise stocks and shares, which, especially in Johannesburg and Cape Town, are frequently pledged to the bank as security. Stock and share certificates enjoy a limited negotiability inasmuch as they may pass through many hands merely with blank transfers attached. Stock available for investment purposes comprises municipal stock and Union Government Stock. In addition the Union Government issues from time to time Treasury Bills for sums of £500, £1000, and £10,000 for fixed periods of ninety days, six and twelve months. The general practice now is to issue Treasury Bills at a discount and on and after May 21, 1926, the rates have been:

90 days	3%	discount
6 months	3½%	"
12 months	4%	"

THE BANKING SYSTEM

Commercial Banking. The Union of South Africa can claim the possession of only five commercial banks: viz., two British institutions, two South African, and one Dutch institution. It would be nearer the truth, however, to say that the Union's population, scattered over an area of 470,000 square miles, has at its disposal one and three quarter banks, since the total business of four of these five banks does not exceed 75% of that of the largest of them. The situation is the outcome of a long process of evolution which must be briefly traced.

Brief Survey of Banking Development. Banking in South Africa dates from the year 1793 when, by the easy means of the printing press, a capital of 680,000 rixdollars was provided, and the first and only hundred per cent government owned and controlled bank of South Africa was established, i.e., the Lombard or Loan Bank. Rds. 165,000 and Rds. 500,000 were added to its capital in 1802 and 1810 respectively. In 1808 the Government Discount Bank was established as a branch of the Lombard Bank. Thus the Government came to enjoy a banking monopoly until 1837, but as the result of subsequent competition, this institution ceased to exist in 1842.

Private initiative was stifled throughout the period 1825 to 1836, during which several unsuccessful attempts were made to obtain charters and to establish private institutions. In 1836, however, governmental sanction was ignored when under Trust Deed the first private South African banking institution, the Cape of Good Hope Bank, was established with a capital of £75,000, and commenced operations in 1837. This lead was followed and in rapid succession banks were opened all over the country, so that by 1862 there were no fewer than 29 such banks in existence at the Cape with a trading capital of £3,350,000. The flourishing state of the banks, which were paying handsome dividends, ranging from 12% to 22%, naturally attracted the attention of British investors.

With the advent of the Imperial Banks, the first of which, the London and South African Bank, opened in South Africa in 1861, a new era dawned upon the country, an era of wholesale amal-

gamations, liquidations, and of a tremendous extension of the branch bank system. At least six English banks have operated in South Africa at some time or other. Only two of these are still in existence, and one of them — Barclay's — commenced operations only in 1926.

Eighteen to twenty of the Cape banks were absorbed by British banks, two or three by other Cape banks, while the remainder were wiped out in the crises of 1877, 1881, and 1890. Of the five banks established in Natal, four went out of existence after a brief lifetime between 1865 and 1870, while its pioneer institution, the Natal Bank, established in 1854, was absorbed in 1914. The four banks of the Free State were all absorbed, and the Transvaal's only institution, the National Bank of South Africa, merged with Barclay's in 1926. In 1920 came the American invasion with the establishment of a branch of the National City Bank of New York, which, however, was liquidated about a year later. In 1924, the only two Dutch banks operating in the country were fused.

Thus we find that of the existing banks, the Standard Bank represents a consolidation of no fewer than seventeen institutions, including two British; Barclay's Bank (as far as South Africa is concerned) a consolidation of at least eleven institutions, including two British: the Netherlands Bank, a consolidation with the only other Dutch bank, viz., the Transvaal Commercial Bank. The Stellenbosch District Bank and the Colonial Banking and Trust Company on the other hand have absorbed no others. South Africa's grand total of about fifty banks established since 1837 has dwindled to five, the relative importance of which will be brought out by the following figures: —

Bank	In the Union	Outside the Union	Total
Standard..........	£35,614,000	£24,378,000	£59,992,339
National...........	28,476,000	10,753,000	38,728,642
Netherlands........	1,926,000	1,468,000	3,393,328
Stellenbosch Distr...	328,000	————	327,800
Colonial...........	601,000	22,000	622,974
Total..........	£66,945,000	£36,621,000	£103,065,083

Legislation. Prior to the establishment of the Reserve Bank, South African banking legislation concerned itself almost exclusively with the questions of note issue and the publication of bank statements. While those sections of the pre-Union law relating to these two questions have been consolidated in or replaced by the Bank Act of 1917 and the Currency and Banking Act of 1920 and its amendment of 1923, yet to this day the laws as a whole have not been consolidated or repealed except the Natal Bank Statements Law. A very comprehensive bill was drafted in 1920, "To consolidate and amend the laws in force relating to Banks," whereby all previous legislation was to be repealed; but in its stead the Banking and Currency Act was passed and the former bill seems to have been forgotten.

Thus in the *Cape,* banks are still required to furnish the Government with copies of their Deeds and keep it informed of all amendments thereto. Banks with head offices outside the Cape have also to furnish a power of attorney appointing a chief agent, while lists giving the names of shareholders and directors must be furnished annually, copies of which are also to be open for inspection at the banks. In the event of any bank's suspending payment, or at the request of shareholders or depositors, the Government can appoint inspectors to inquire into the affairs of such bank. Finally all Cape banks are required to appoint two auditors annually, subject to the approval of the Government.

The *Free State,* like the Cape, requires banks with their head office outside of its boundaries to deposit a power of attorney appointing a chief agent. In addition to taking out a license, no bank can open in the Free State without the sanction of the Government.

Of the *Transvaal* and *Natal* banking laws, nothing has remained as a result of the passing of the two Union Acts.

Union Legislation. By the Bank Act of 1917, banks are required to furnish in a prescribed form quarterly statements of their assets and liabilities within and outside the Union. Also copies of their annual and semi-annual statements as submitted to their shareholders must be furnished. All these are thereupon published in the *Gazette* at the expense of the banks concerned.

The Currency and Banking Act of 1920, as will be seen, deprived the banks of their note issue privileges, and in addition it

imposed certain new requirements upon the banks, some of which were amended in 1923. Accordingly banks are no longer under any obligation to subscribe to the capital of the Reserve Bank. They are, however, required to maintain with the Reserve Bank reserves of 10% and 3% (originally 13% and 3%) against their demand and time liabilities respectively. This, it should be noted, is the first time in the history of South African banking legislation that banks are definitely required to maintain specific reserves against deposits.

Such is the extent of governmental control of banking in South Africa. But the subject is sure to receive further attention in the near future. In fact, at the 1926 session of Parliament, the Minister of Finance promised to introduce a general law on banking at the next session.

Rôle of the Banks. Owing to the peculiar circumstances of South Africa and especially on account of its small population, the banks in the Union are called upon to provide facilities which in other countries are offered by specialized institutions. Recently one of the banks even ventured to underwrite a large municipal loan, which proved a great success. Normally the banks advance money for all purposes, long term, intermediate and short term, under the cloak of "overdrafts" which are nominally repayable on demand. As far as possible the banks are inducing their customers to secure their long-term credit needs from insurance companies and other institutions of that nature. One bank even went to the extent of forming a subsidiary company to provide the long-term needs of industry. But as it was formed just prior to the slump, it has not been very successful so far. In the financing of foreign trade, the banks naturally play a very important rôle, most of it being done under letters of credit. Finally, the banks also finance stock exchange transactions to a certain extent. Generally not more than 50% is advanced and then only on tested dividend paying securities.

Investment Banking. The principal South African securities are listed on the Stock Exchanges, the chief of which is at Johannesburg. It is interesting to note that gold mining shares are most popular in the Transvaal, in contrast with the Cape where there is a decided preference for government and municipal stocks. But, strictly speaking, there are no institutions in South

Africa which underwrite and place loans. Municipalities as a rule issue a prospectus inviting applications direct to themselves, but allowing brokers and financial agencies a small commission for all subscriptions they obtain. This practice is also followed by the Government. In some cases, however, municipalities obtain loans direct from insurance companies. It might also be mentioned that, by the Local Loans Act of 1926, provision is made for the granting of loans to local authorities by the Government through the Public Debt Commissioners. Not more than £100,000 may be advanced to any one local authority, and the amount advanced or to be advanced, when added to the existing debt of such body, must not exceed in all the sum of £250,000.

For the rest, South Africa possesses most of the investment institutions that are to be found elsewhere. Their scope, however, is somewhat restricted owing to the peculiar circumstances of the country, which is still predominantly agricultural. Accordingly they are primarily engaged in mortgage business, advancing money against land. On account of the operations of the Land Bank, it is interesting to observe, insurance companies are now being forced to grant advances on town properties also. A brief discussion of the more important types of institutions follows: —

Trust Companies. Specialization, which a large population like that of America justifies, can naturally not be expected in a country with a European population of less than two million. Hence nothing of the nature of the typical American Trust Company is to be found in South Africa. Fiduciary functions are here performed by the following: —

(1) *Private Individuals,* who for some personal reason, ability, or special knowledge, have been appointed to act as trustees by will, deed, or order of the Courts.

(2) *Corporations* registered as incorporated concerns, i.e., Trust Companies. These are found scattered all over South Africa, but the overwhelming majority combine with their trust work other functions such as insurance, auctioneering, real estate, and general agency work. A few typical companies taken at random are: the African Board of Executors and Trust Company Limited; The Fichardt Estates, Executors and Trustees

Limited; the Bredasdorp Board of Executors, Trust and Insurance Company Limited; Syfrets Trust Company Limited.

(3) *Special Firms* not being incorporated as Trust Companies: e.g., Accountants, Real Estate Agents, Auctioneers, and others who also do a large amount of trust work, especially in the smaller towns.

(4) *The Commercial Banks,* which are absolutely unrestricted as far as the nature of their operations is concerned. They also do general trust work, though one of them has organized a separate company for this phase of its operations, while another has a big financial interest in a local Trust Company.

(5) *The Attorneys at Law,* who probably perform the greatest amount of fiduciary work in South Africa. It is the usual custom among country as well as town attorneys to carry on an agency, trust, and auctioneering business in conjunction with their legal practices. It is admittedly impossible for an attorney in the country towns and villages to make a living by strictly legal work, and quite three-fourths of the income of many of them is derived from work other than legal. This may not be a very desirable state of affairs, but it is inevitable under the circumstances of the country, and the practice is tacitly recognized by the Courts.

Attempted Consolidation. At the beginning of 1920, the South African Board of Executors and Trust Company Limited was established with the avowed object of acquiring the business of old established and prosperous trust and general agency concerns of the country until the company should have branches in every town and village in South Africa. A beginning was made in the Free State where the agency, trust, and auctioneering businesses of some thirty attorneys were bought up. In the majority of cases, these attorneys were appointed managers of the branches, while at the same time they were allowed to retain their legal practices. As a result, the existing Boards of Executors also vigorously entered the field of buying up attorneys' trust departments and opening new branches everywhere, while new local Boards of Executors were also established in many localities.

The Incorporated Law Society considered the conduct of these attorneys unprofessional. A test case was taken to the Supreme

Court, the Appeal Court, and ultimately to the Privy Council. In spite of their appeals, however, the attorneys were ordered either to resign as managers of these branches or to surrender their professional papers. The former alternative was adopted, and the whole movement received its deathblow.

Savings Banks. South Africa can boast only seven savings institutions (three of which are really People's Banks and are dealt with elsewhere), in addition to the Post Office Savings Bank and the savings departments of the Commercial Banks and the Building Societies.

The oldest of these institutions is the Cape of Good Hope Savings Bank, established by Act of Legislature in 1831. At one time it had branches in practically every locality in the Cape, but with the establishment of the Government Savings Banks, it withdrew, and has since concentrated on Cape Town. The others also concentrate their efforts on one locality only.

Like the Commercial Banks, the Savings Banks have thus far enjoyed absolute liberty as far as their operations are concerned. In 1921, a bill was drafted by the Treasury " to control the investment of Funds held by the Savings Banks," which was to have been introduced by the Minister of Finance in 1922, but which was dropped.

Post Office Savings Banks. Post Office Savings Banks were established in South Africa as far back as 1868, when Natal passed the " Government Savings Bank Law " followed by the Cape in 1875. For a while, these offices were in charge of the magistrates, but shortly afterwards they were transferred to the Post Offices. The Transvaal Republic did not provide its Postal Savings System until 1892, followed by the Orange Free State in 1897. The four systems were consolidated in 1911. The system as it exists to-day provides for deposits of one shilling or any multiple thereof, but not more than £200 net in any one year, nor more than £1000 in all including interest. Provision is made, however, for the additional investment in Savings Bank Certificates of £100 each up to £1000.

Commercial Banks. All the commercial banks have separate Savings Banks Departments. The savings so obtained are not specially invested, however, but are merged with their ordinary funds.

It is apparent from the above that the few real savings banks are confronted with severe competition, but most of all, probably, they are affected by the unfair competition of the Post Office Savings Banks. Not only do the latter pay high rates of interest and allow a high limit for deposits, but in addition interest paid by the Post Office Savings Banks is exempt from income tax. Moreover, the Post Office Savings Banks also are in charge of the issue of Union Loan Certificates, which are sold to the public at 16/– and are worth 20/– and 26/– after 5 and 10 years respectively. In this way also the other savings banks are no doubt deprived of substantial amounts.

In conclusion it might be observed that, under the Banking and Currency Act, all institutions calling themselves " Banks " were required to maintain reserves against their deposits. Accordingly many such institutions were induced to drop the word " Bank." But since banks are exempt from the operation of the Usury Law of 1926, the tendency is again in the opposite direction, and more so-called banks are coming into existence. Efforts are therefore being made to have the Usury Law amended to prevent the use of the word " Bank " by any but genuine commercial banking institutions.

Land and Agricultural Banks. As in the case of the Post Office Savings Banks, so in the provision for farmers' long-term credit needs, South Africa was ahead of the United States. Government Land and Agricultural Banks came into existence in the Transvaal in 1907, in the Orange Free State in 1909, and in Natal also in 1907. The necessary legislation had been passed in the Cape also in 1907, but the Act remained inoperative. In 1912, the Union Parliament provided for the establishment of the Land and Agricultural Bank of South Africa with which the above institutions were merged. Thus capital funds to the amount of £2,735,000 were transferred from these provincial institutions to the new one.

Management. In contrast with the United States, South Africa has only one bank which is controlled by a central board consisting of a Managing Director and five ordinary members who are all nominated by the Governor-General. The Union is, however, divided into five areas, for four of which local boards of three members each are also appointed by the Governor Gen-

eral, while the fifth area is in the care of the Central Board of Pretoria. These local boards have no executive functions whatsoever. Their main function is to consider and transmit all applications submitted to them, with their recommendations thereon, to the Central Board, and generally to advise the Central Board upon all matters on which it may require their advice.

Capital. The Bank's capital is not fixed but consists of: —

(a) the above £2,735,000;
(b) such further sums as Parliament may vote from time to time;
(c) such amounts as the bank may recover in respect of certain advances made in the past, for constructing dipping tanks and erecting fences;
(d) such further amounts as the bank is authorized to raise for the purpose of financing coöperative societies by means of
  (1) discounting bills of coöperative societies with other banks,
  (2) overdrafts with other banks,
  (3) issuing Land Bank bills, and
  (4) receiving moneys on deposit withdrawable at not less than one month's notice.

Parliament has annually, with one exception, voted certain sums for the Land Bank, so that on December 31, its capital funds and the reserve funds amounted to £8,683,768 and £460,114 respectively, Land Bank Bills outstanding to £1,400, and deposits to £513,699. It is accordingly a hundred per cent owned and controlled state institution. But the bank pays interest on all the funds it has received from the Government at an average rate of 4.57%, which is approximately the rate it cost the Treasury to raise those funds. Further, the bank pays the ordinary full rates for services rendered by the postal and railway administrations, and has its own superannuation fund for the benefit of its officers.

Operations of the Bank. The bank is empowered to make: —

(1) Advances on mortgage of land (freehold or quit rent) known as "ordinary advances."

(2) Advances on Crown Land,
  (a) held under agreement of purchase or
  (b) held under lease, the unexpired period whereof is ten years or more.
(3) Advances to coöperative societies and companies
  (a) for a maximum period of ten years, repayable in instalments,
  (b) on a "cash credit account."
(4) Dipping-tank advances,
  (a) ordinary; (b) to local authorities; (c) through the Native Affairs Department.
(5) Fencing advances.
(6) Advances for the construction of silos.
(7) Water supply and windmill advances.

(1) Ordinary advances are made to farmers for (a) improvements, (b) the purchase of stock or plant of all kinds and of agricultural requirements generally, (c) the discharge of existing liabilities, (d) the payments of costs incidental to the subdivision of land held in undivided shares, (e) the establishment and promotion of agricultural and rural industries, (f) the purchase of land for any of the purposes described in (a), (b), and (e), (g) the execution of large agricultural works or improvements specially authorized by the Governor-General, and finally (h) irrigation, water storage, and boring works.

Except for special cases, no advances are made for less than £50 or for more than £2000 except under (g) when the maximum amount is £5000. Nor may the advance exceed 60% "of the fair agricultural or pastoral value" of the land offered as security, together with the value of the improvements to be effected, as determined by the Central Board. Such advances are repaid in equal half-yearly instalments consisting of capital and interest within a period not exceeding 30 years. This period naturally varies according to the purpose of the loan, and is generally 20 years. Interest is payable at a rate fixed by the Board, depending primarily on the cost of the capital to the bank. Up to August 1921, 5% per annum had been charged, but it was then raised to 6% and is at present still 6%.

(2) Advances on Crown Lands may also not exceed £2000.

(3) A. Advances for not more than ten years are made to Coöperative Societies for the purpose of purchasing (a) immovable property (and erecting buildings thereon), (b) agricultural machinery to be worked on behalf of members, (c) live stock to be controlled and used on behalf of members, and (d) plant, office furniture, and other equipment for carrying on business of the society.

B. Advances in the form of a "cash credit account" are made for the purpose of (a) making advances to members against produce actually delivered to and accepted by the society; (b) purchasing grain bags, agricultural implements, seeds, and farming requisites generally to be supplied to members.

(4) The advances for the making of dipping tanks were originally made by the Department of Agriculture, but since 1912 the Bank is in charge of these advances also. The Bank may advance any sum which the Department of Agriculture considers sufficient to cover the initial cost of constructing a dipping-tank upon a holding. These amounts generally do not exceed £150. On an average they amount to £109 and are repayable in ten years.

(5) Fencing advances, repayable in twelve years, are made under similar conditions.

(6) Similarly, advances for constructing silos, which may not, however, exceed £150, and which are repayable in ten years.

(7) Water supply and windmill advances have been granted only since 1926. During that year, 378 applications were received. The maximum amounts are £250 at 5% and the advances are granted for five years.

Intermediate Credit. Provision for intermediate credit was not made until 1926 when the "Agricultural Credit Act" was passed. As in the case of the Land Bank the machinery created by this Act differs essentially from that in America. The Act provides for the division of the country into areas known as *Agricultural Loan Circles*, within each of which an *Agricultural Loan Company* may be established. As in the United States, the whole machinery is under the control of the Central Board of the Land Bank, which has divided the country on the basis of the existing magisterial districts, which would provide for the establishment of about 200 Loan Companies. But for the present

only 14 are to be established. Provision is further made for the establishment of *Rural Credit Societies* within such Loan Circles, consisting of not fewer than seven and not more than fifteen persons, except in special cases, devoting attention to farming. These Loan Circles are essentially borrowers' clubs which will obtain their funds by discounting bills with the Loan Companies, each member of such circle being liable for an amount of £200 times the number of members belonging to such circles.

These Loan Circles are much of the same nature as the American Farm Loan Associations, and as in their case, the Loan Circles are required to subscribe towards the capital of the institution. In this instance, however, only an amount of 1% of the advances they receive must be subscribed, which remains a permanent investment until such Circle is dissolved.

Capital of Loan Companies. The minimum capital required before commencing operations is £5000 per company, consisting of £1 shares. Shares are offered to the public for 60 days on such terms and conditions as the Central Board may determine. Any portion of the £5000 not subscribed for by that time is thereupon taken up by the Central Board on behalf of and out of the funds of the Land Bank. Subsequently the capital is to be augmented by the 1% contributions of the credit societies. Dividends are limited to 8%, except that the Land Bank is not entitled to more than 5% on the shares it holds. Subscriptions have already been invited for several of these companies, but it is expected that the Land Bank will probably have to advance the entire capital.

The idea is that the companies shall ultimately be farmer-owned-and-controlled institutions. Accordingly it is provided that whenever the credit societies, by their 1% subscriptions, have subscribed such an amount to the capital of a Loan Company as the Central Board may in any particular case determine, such company is to apply 25% of any further subscriptions of the societies to the payment and retirement at par of all the shares held by parties other than credit societies. Shares held in the names of persons other than the bank are to be retired first, and thereafter those held by the bank.

All companies are required to establish and maintain a Reserve Fund of at least 25% of their paid-up capital. In addition

they are required to deposit all moneys with the Land Bank, which is to act as their bankers.

Business of Loan Companies. The most important business of the Loan Companies will be the discounting of bills indorsed by the credit societies. Provision is also made, however, for advances to individuals against the security of grain or other agricultural produce, provided such produce is to be sold through some coöperative argicultural organization. The companies are also empowered to accept deposits and in case of need can rediscount with the Land Bank. Finally, though no general Warehouse Law exists, these companies alone are allowed to accept warehouse receipts as security.

The machinery has thus been provided to meet the general needs of agriculture, but in contrast with America, South Africa makes no provision for advances for the purpose of raising, breeding, fattening, or marketing of live stock. It is hoped to supply the farmer with his short-term credit needs at a cost of about 8% per annum. The whole scheme is admittedly an experiment, and time alone will show whether this extensive machinery can adequately provide for the needs of South African agriculture. Eight companies with a minimum capitalization of £40,000 in all have been formed to date (December 1926), but the total subscriptions received from the public have amounted to only £58. Fortunately, the Land Bank does not consider this the public's estimate of the project, for it is already in communication with sixteen more districts with a view to establishing additional Loan Companies.

Mention must also be made of the facilities afforded by the Lands and Irrigation Departments. The former makes large advances primarily to settlers, for the purchase of land, on most reasonable terms. The latter provides the agricultural community with the necessary funds for large irrigation schemes.

Building Societies. The most successful coöperative credit institutions in South Africa are no doubt the Building Societies, the first of which was established in 1864. Their number has steadily increased and reached 56 for the year 1923–4.

There is no Building Societies Law in existence in any province of the Union. The only legislation which affects Building So-

cieties is the Union's Statistics Acts, under which they are required to furnish certain information for purely statistical purposes. A bill for the regulation and control of these societies was introduced in the Transvaal in 1909, but was dropped. As recently as 1921, a bill was again framed, "To provide for the registration, incorporation, regulation, management, and dissolution of building societies." The bill was to have been introduced in the 1922 session of Parliament, but for some reason it also was dropped and nothing has since been heard of it. The 1926 Consolidating Companies Act, however, would suggest the possible rehabilitation of a bill of this nature.

People's Banks or Credit Unions. In addition to the Savings Banks, the majority of which are of the Mutual type, there are three People's Banks in the Union, one at Pretoria, and two at Bloemfontein. Two of these are of the Raiffeisen type,[6] and the third of the Schulze-Delitsch type. The two former, at all events, are run on quasi-philanthropic lines, their main object being to assist on a commercial basis persons who would ordinarily have recourse to the money lender. The Pretoria institution, which was the pioneer, has been exceptionally successful under very able management, and has succeeded in bringing down its interest rates from sixpence to fivepence, and then to fourpence per pound per week; i.e., from 30% to 25% to 20% per annum, and a further reduction is anticipated.

The Schulze-Delitzsch type institution began only in 1922 under the ægis of the Orange Free State Teachers' Association. It possesses a small capital, accepts deposits, and makes advances on promissory notes with two sureties at fourpence per pound per month; i.e., 20%. It makes a specialty, however, of loans to students at 8% during the first year, and 9% during the second year. In addition it advances money on mortgage at 8%.

These three institutions have so far been quite successful and a great boon to the working classes especially. It is stated that the Pretoria institution alone, during its eight years of existence, has saved its 5691 borrowers no less a sum than £103,679 in interest, when compared with the minimum charges of two shillings per pound as demanded by the usurers.

[6] With certain modifications.

Several additional institutions of this nature have been planned in recent years, but have not come into existence either through lack of leadership or on account of the Cape Usury Act, now repealed. But even the existence of those already established is threatened at present, owing to the passing of the Union Usury Act of 1926. According to that law, such institutions are ranking as money lenders, who may not charge more than from 30% to 12%, varying according to the amounts advanced. Such rates are naturally insufficient to allow any People's Banks to be started in our relatively sparsely populated centers, and it is feared that, if no amendment is made to the Act in the near future, the whole movement will be definitely checked.

THE CENTRAL BANK AND THE MONEY MARKET

Inauguration. The central bank of South Africa, the South African Reserve Bank, was, as has already been seen, the direct outcome of the monetary crisis of 1920 and of the Report of the Select Committee though it is worth noting that a "state or privileged Bank" had been advocated in 1911 by a Frenchman, M. Grosclaude: and in 1913, Mr. J. Postmus, then an Inspector of the Netherlands Bank and at present Deputy-Governor of the Reserve Bank, suggested the establishment of a central bank. Legislation was introduced into Parliament immediately after the Report of the Select Committee and the Currency and Banking Act, No. 31, of 1920 (drafted in the Treasury) was passed accordingly and came into force on December 17, 1920, and Chapters II and III of this Act provided for the establishment at Pretoria of "The South African Reserve Bank," the first central bank established as a result of the war. This Act was amended in certain important particulars by the Currency and Banking Act Amendment Act, No. 22 of 1923 (in force June 19, 1923). It has always been urged, quite mistakenly, that the Act of 1920 was modeled very closely on the United States Federal Reserve Act. A careful comparison of the text, however, will show greater resemblance to the statutes and provisions of the Netherlands Bank and the Java Bank. The regulations taken from the United States Act were those concerning:

(1) cash reserves for demand and time deposits;
(2) classification of directors;
(3) subscriptions by the commercial banks to its capital;
(4) suspension of reserve requirements.

Local Organization. The bank is a corporate body with head office at Pretoria. The bank management consists of a board of eleven directors, of whom originally three, experienced in banking and finance, were nominated by the stockholding banks and appointed by the Governor General, and were known as the banking representatives; three (described as the commercial and industrial representatives) who at the time of their election had to be actively engaged, one in commerce, one in agriculture, and one in some other industrial pursuit, were elected by stockholders other than banks; and three, described as the Government representatives, appointed by the Governor General who also appointed the remaining two, the Governor and Deputy-Governor. By the Amendment Act of 1923 the banking representation was abolished on June 30, 1923, and six directors (the commercial and industrial representatives) who must be or have been actively engaged, three in commerce or finance, one in agriculture and two in other industrial pursuits, are now elected by the stockholders. The remaining five are appointed by the Governor General as before. The reason for this change was that the board found it difficult to discuss certain aspects of banking policy before representatives of the banks. All the Directors or alternate directors (for which provision is made) must be British subjects and must reside in the Union. Directors on retirement are eligible for reappointment or reëlection and no person can be appointed as director or alternate director if he is a director, officer, or employee of another bank or a member of Parliament or of a Provincial Council.

Capital. The original capital of the bank, one million pounds, of which not more than fifty per cent was to be subscribed at par by the commercial banks in proportion to their paid-up capital and reserve at the commencement of the Act, and the public was to subscribe the remainder at par, any balance still remaining to be taken up by the Government. No stockholder, other than a subscribing bank and the Treasury, may hold more

than £10,000 of the capital stock and, by the Amendment Act, the commercial banks are no longer required to hold Reserve Bank stock and if they sell their present holdings they may not reacquire stock beyond a total of £10,000. Each stockholder has one vote for every £100 of stock except that in 1923 the voting power of the commercial banks was limited to £10,000. The capital of the bank may be increased with Treasury approval and the price of stock for that purpose may be fixed by the board with the approval of the Treasury, any premium thus obtained to be added to the reserve fund.

Reserve Fund and Allocation of Surplus. Provision is made for the creation of a reserve fund which will ultimately be equal to the paid capital. No dividend (cumulative) exceeding 6 per cent was to be paid as long as restrictions on the export of gold or on the convertibility of gold certificates were in force and during such period any profits after paying a dividend of 6 per cent were to be placed to a special fund for strengthening the gold reserve of the Bank. This special fund (amounting to £258,498.1.5 on March 31, 1925) was, after legal advice had been taken, " placed to the ordinary reserve fund " on the resumption of gold payments — though doubt may be expressed as to whether this method of disposal was strictly in accordance with the terms of the Act (S.11(1)). Later, profits in excess of 10 per cent dividend will be paid to the Government. The Bank can also make such provisions " usually made by bankers," e.g., secret reserves, contingencies, etc.

Powers and Duties of the Bank. The Bank may establish branches and appoint agents and correspondents in any part of the Union and may also appoint agents and correspondents, and, with the consent of the Treasury, may also establish branches and local committees in places outside the Union. It may act as bankers and financial agents of the Government including the railways and harbors administration, provincial administrations, and Government institutions, and it is required to fix and publish from time to time the rates at which it will discount the various classes of bills.

Business of the Bank. The Bank may engage in the following business: —

i. Make and issue bank notes.

ii. Accept money on deposit, on current account and collect money for customers.

iii. Buy and sell or rediscount bills of exchange, promissory notes or other commercial paper, having at least two good signatures, not exceeding ninety days. A fifth of this business may be six months' bills for agricultural purposes or based on live stock It may deal in the same way with bills drawn for the purpose of trading in Union Government securities and (since the Amendment Act) it may buy, sell, or rediscount bills of the Union Government or of a local authority in the Union having not more than six months to run.

iv. Make loans and advances on specified securities.

v. Make transfers by telegram or letter, etc., to places abroad.

vi. Buy and sell stock, etc., having not more than six months to run of the Union Government and of local authorities in the Union, may invest a sum not exceeding its paid-up capital and reserve in securities having not more than two years to run of the Union or other Governments and may invest its staff and superannuation funds in Union Government securities of any currency.

vii. Buy and sell securities for customers.

viii. Buy, sell, or deal in precious metals.

ix. Accept the custody and management of moneys, securities, and other articles of value.

x. Open accounts in foreign countries and act as agent for any bank.

Prohibited Business. The Bank may *not*, however: — engage in trade or have a direct interest in any commercial or industrial undertaking except as specially provided above; purchase its own stock or the shares of any other bank or grant security upon them; advance money on mortgage of fixed property or on notarial bond or cession thereof or become the owner of fixed property except for its own business premises; make unsecured loans or advances; draw or accept bills payable otherwise than on demand; accept

money on deposit for a fixed term or allow interest on credit balances on current account.

Issue of Notes. The Bank has the sole right to issue bank notes in the Union for a period of twenty-five years from the commencement of the Act, but certain provisions were made (including a 40 per cent gold specie reserve and a tax at 3 per cent per annum on any excess issue over that of December 31, 1919) with regard to the notes of the commercial banks pending at the time when the Bank should be in full operation and, on a date to be determined, the commercial banks were to cease to issue or re-issue notes. The several laws in force relating to bank notes were repealed and two years from the appointed day each of the other banks had to pay over the amount of its notes still outstanding to the Bank which then assumed all liability for them. The Treasury had to prescribe the denominations of notes, which are redeemable in gold specie or gold certificates. It will be noticed that the Bank has the sole right to issue " bank " notes. It would perhaps be desirable in subsequent legislation to delete the word " bank " before notes and thus preclude the possibility of any future Government note issue, though with the issue of 10s notes by the Reserve Bank this loophole has virtually disappeared.

Reserve Against Notes. The note issue is secured to an amount of not less than 40 per cent in gold or gold specie, and the remainder in commercial paper or trade bills, and by a first charge on all the assets of the Bank. By the Amendment Act, up to June 30, 1928, Treasury bills of the Union Government or the British Government of a currency not exceeding 90 days can be used as security for the note issue up to 35 per cent of the total note issue or 140 per cent of the total amount of commercial paper or trade bills held by the Bank. The Bank may with the consent of the Treasury hold gold balances outside the Union earmarked for the Bank's account under specified conditions, to an amount not exceeding one-fourth of the total reserve requirements. By the Amendment Act, too, the Reserve Bank notes became legal tender throughout the Union except for payments tendered by the Reserve Bank.

Suspension of Reserve Requirements. Subject to the consent of the Treasury the Bank may suspend for a period not exceeding

thirty days, and may renew such suspensions for periods not exceeding fifteen days, the specified reserve requirements provided that upon the amounts by which the reserve for notes of the Bank falls below the requirements of the Act a graduated tax shall be paid to the Treasury at the following rates: —

> One per cent per annum when the gold reserve against notes is less than 40 per cent, but not less than 32½ per cent; and in addition 1½ per cent per annum upon each 2½ per cent decrease, or part thereof by which the reserve falls below 32½ per cent.

The Bank must increase its rates of interest and discount by at least the same percentage, and for the purpose of ascertaining the gold reserve held against notes, allowance must first be made for the reserve of 40 per cent required to be held against deposits (see below). With the exception of the above-graduated tax the Bank is exempt from the payment of any tax or duty upon its note issues.

Metallic Reserve for Deposits. The Bank must hold in gold or specie a reserve of at least 40 per cent of its deposits and bills payable in addition to the gold reserve required against its bank notes: (not more than one-fifth of this reserve may be silver specie). One-fourth of such reserve may, with the consent of the Treasury, be held outside the Union provided such reserve is held in the Bank's custody or is deposited in another bank and earmarked for its account.

General Provisions. Provision is made for auditing the Bank's books and records. The Bank must also transmit to the Treasury weekly, for publication in the *Gazette,* in a specified form, an account of the notes issued, gold and silver coin and bullion and gold certificates held and of the other liabilities and assets of the Bank; and other statements and accounts must also be published.

Cash Reserves. Every bank transacting business in the Union must hold reserve balances in the Central Reserve Bank equal to at least 10 per cent of its demand liabilities in the Union other than notes and 3 per cent of its time liabilities to the public in the Union. In the original 1920 Act the reserve holding against

demand liabilities was 13 per cent, but this was reduced in 1923 to the present figure of 10 per cent. All such banks are also required to render to the Treasury for publication in the *Gazette* monthly returns of certain stipulated items, to which certain additions were made in 1923.

Establishment of the Bank. The Act came into operation on December 17, 1920, and Mr. W. H. Clegg, Chief Accountant to the Bank of England, was appointed first Governor. Of the total capital to be raised £300,000 was allotted to banks, the remainder being offered to the public at par. Up to June 18, 1921, when the list was closed the amount applied for was only £365,000 leaving £335,000 to be taken up by the Government. This fact gave rise to a situation in which, by contrast with the Federal Reserve System, the Government had a large interest as stockholder in the operations of the Bank. The Bank opened on June 30, 1921. In December of the same year it notified the Treasury that it was in a position to issue notes under the terms of the Act (S.15(2)). A proclamation (No. 14 of 1922) was issued declaring that on June 30, 1922, all other banks should cease to issue or re-issue bank notes. The Treasury subsequently prescribed the following denominations of notes to be issued: — 10s, £1, £5, £20, £100. However, as there was found to be a shortage of £1 notes, the Reserve Bank at the request of the other banks actually began issuing in April. By the end of July the transition was practically accomplished. By July 1922 the amount of notes in circulation was nearly £6,500,000. At the same time between December 31, 1921, and June 30, 1922, the circulation of the other banks within the Union was reduced by less than £1,250,000. Under the Act (S.15.(3) (c)) the commercial banks transferred the liability for their outstanding notes, amounting to £443,084, to the Reserve Bank on June 30, 1924, but outstanding notes of the Bank of Africa Ltd. (including Cape legal tender notes) the Natal Bank Ltd., and the National Bank of the Orange River Colony Ltd., which the National Bank of South Africa Ltd. had absorbed, were not paid over by the latter bank to the Reserve Bank and the Courts in 1925 upheld the view that "its notes" in Act No. 31, 1920, (S. 15(3)) (c), did not include notes of the absorbed banks. It is understood, however, that the National Bank, after winning the case, voluntarily returned to the Treasury the securities in

respect of a portion of these notes, namely, the Cape legal tender notes of the Bank of Africa Ltd.

Until the issue of its notes, the business of the Reserve Bank was chiefly confined to granting advances to the Government and acting as a clearing house for other banks, and since then it has been engaged in building up a rediscount business. These functions will be examined in detail later on.

Early Operations of the Reserve Bank. Before attempting to discuss and appraise the actual operations of the Reserve Bank, it will be well to examine briefly the earlier period of its work and some of the weaknesses pointed out in the Kemmerer-Vissering Report. It must be remembered too that the Union is a large country (473,000 sq. miles) with a population of about 7 millions, of whom only 1½ are Europeans and of these considerably more than half are concentrated in a few inland and coastal towns. Mining (chiefly gold and diamonds) and agriculture are the principal occupations, though industries fostered by a tariff are rapidly increasing.

The Reserve Bank did not actually open until June 30, 1921, and therefore much of its history has been during the period of South Africa's deflation, a deflation that was necessary if the country was to return to the gold basis without reducing the gold content of its sovereign; and a period of deflation is no time for a newly organized central bank to extend its business by low rates and liberal credits either to the banks or to the public.

Reserve Bank Misunderstood. Moreover, there has been all along a complete misconception on the part of the public and the commercial banks as to the functions of the Reserve Bank. Its establishment was strongly opposed by the commercial banks, who saw in it a possibile competitor, and it is clear from the evidence before the Gold Standard Enquiry Commission 1924–25 that a "gentleman's agreement" was affected with a view to limiting its scope of operations and curtailing its competition. The idea, therefore, though utterly contrary to the text of the Bill, fostered by certain expressions in Parliament during the passage of the Currency Bill and by the attitude of the other banks, gained general acceptance, even among the commercial community, that the bank was exclusively a banker's bank and could not deal with the public (See QQ.3829–3854) — an impossible

idea even considering the circumstances of its birth when there were five or six commercial banks, but rendered quite stupid when, by amalgamation and absorption, those banks have been virtually reduced to two large banks, the Standard and the National (now Barclays), constituting a close monopoly, and by agreement carrying out a common policy of exchange rates (apparently then fixed quite arbitrarily), discount rates and commercial practice. Not only, therefore, in the first three years of its existence was there practically no competition between the commercial banks, but, by agreement, the Reserve Bank did not provide the competition which by its powers it could legally have exercised.

A further consideration is that the two large commercial banks have capitals and reserves much in excess of the Reserve Bank:

	Capital paid up	Reserve Fund	
Standard Bank Ltd......	£2,229,165	£2,893,335	Dec. 31, 1924
National Bank Ltd.	2,075,500	150,000	"
The S. A. Reserve Bank...	1,000,000	152,825	Jan. 24, 1925

Consequently they had no need to call upon the Reserve Bank; the National Bank, it is true, rediscounted to a certain extent with the Reserve Bank during the first two or three years of its existence, but the Standard Bank all along maintained a position of aloofness and independence.

Another factor in weakening the position of the Reserve Bank is the open credit system in the country, to which despite protestations to the contrary and many promises to remedy it, the commercial community and the commercial banks seem indissolubly wedded, though it is indubitable that the rate quoted by the Bank is itself a serious stumbling-block to the development of the bill system.

Moreover, in contradistinction to the well understood and generally accepted principle that Central Banks should be the chief depository of Government Funds, the Reserve Bank has in the past not been utilized at all in this way though it will be in future (from January 10, 1927).

Born in a time of financial stringency, therefore, disowned by

the banks, unutilized by the Government, its functions completely misunderstood by the public, it is not surprising that the Reserve Bank during the first two or three years of its existence was a somewhat ineffective institution.

The above defects were pointed out in the Kemmerer-Vissering (Gold Standard Enquiry Commission) Report of 1925 in which the following suggestions were made for the better functioning of the Reserve Bank with a view to its assisting the maintenance of the gold standard. It was pointed out that there is no room in South Africa for a bank which is almost exclusively a banker's bank.

> "The bank must be affected with a great public interest and must enter the open market when the public interest demands that it should. It must be able to cover its expenses, build up a reasonable reserve and pay adequate dividends on its capital in normal times. For this it has nearly adequate powers under the Act, but the following suggestions requiring minor changes in present law are made."
>
> (1) Loans not exceeding 120 days on bills or one name paper secured by warehouse receipts for staple commodities not exceeding 75 per cent of value;
>
> (2) Direct loans not exceeding 15 days, up to the amount of the Bank's paid-up capital, to member banks which are collateraled by bills which the Bank may rediscount and or by short-time government and municipal securities.
>
> (3) Investment in Union Government or municipal notes or bills with maturities exceeding six months to the amount of the Bank's paid-up capital.
>
> (4) Extension of usance for discounting from 90 to 120 days.
>
> (5) Modification of the requirements as to gold balances abroad.

Administrative Changes Suggested. The following administrative changes were also suggested with a view to the Bank functioning more effectively: —

(1) The issue of 90-day Treasury bills;
(2) Preferential rates for trade acceptances;

(3) Use of the Bank as the chief depository for Government funds.

(4) The opening of branches in the principal towns in the Union and in London.

Some of these administrative changes have now been effected: 90-day Treasury bills are now issued; as from January 10, 1927, practically all the Government accounts will be transferred from the National Bank (now Barclays, Dominion, Colonial; and Overseas Ltd.) and the Standard; branches were opened during 1925 and 1926 at Johannesburg, Cape Town, Durban, Port Elizabeth, and East London, but several more should be opened as soon as possible and also a branch in London; and the Bank has not yet quoted preferential rates for first-class commercial paper. It is understood that legislation will be introduced this Session to effect the legal changes suggested by the Commissioners. We are now in a position to examine the work of the Reserve Bank to date.

Clearing and Collection of Checks. On account of the fact that banking in South Africa is almost entirely confined to two large corporations and transactions between different branches of the same bank are not put through a clearing house, the Clearing House Returns in the Union, though not without considerable interest, must be interpreted with caution. Clearings take place in every town in which two banks have branches. The present clearance system is closely related to the English system, except that in South Africa, instead of a separate clearing institution, one or the other bank or even branch takes over the duties of the clearing house in its own center. The clearing-house system in Pretoria is representative of the other clearing houses of the Union except that only in the adjustment of final balances is there any appreciable difference. It should be noted that the Reserve Bank will not grant par remittances between its branches as logically it should, since its notes are remitted at par. Clearances in Pretoria are controlled by the Reserve Bank which has a special room in which each member bank is allotted a place. The Clearing House is managed by a Committee composed of one representative member of each bank or branch bank and presided over by a Chief Teller or Inspector of Clearances, a Reserve Bank official, who is

also Chairman of the Committee. All members must conform to the rules laid down by the Reserve Bank. Provision is made for the calling of meetings for urgent business and a quorum consists of three members and the Chairman, who manages the clearing house. Checks, bills, demand drafts, and orders are passed through the clearing house but bank notes, country checks, and coupons for the payment of interest on bearer bonds are not. The Reserve Bank furnishes each member with all the necessary books and documents and the books of each clearing bank must show the totals of each clearing delivered to and received from other banks or branches of banks and all totals must be agreed.

Inspector of Clearances and His Work. These confirmed totals are daily recorded in the books of the Inspector of Clearances, who then gives each member a statement showing the amount which has been passed to the debit or credit of the bank's current account in the books of the Reserve Bank in settlement of the day's clearances, and the daily balances thus arrived at are adjusted by transfers between the current account of the various member banks in the books of the Reserve Bank. To meet the possibility of debit balances in the Reserve Bank, the latter fixes an overdraft for each of the banks on any excess of which interest is charged and the excess must also be reduced, usually by the discount of bills. Any bank unable to provide funds for the day's settlement, i.e., which cannot reduce any excess overdraft balance, is prevented from using the Clearing House till this is remedied.

Fortnightly Statement. The Reserve Bank renders a fortnightly statement of the current account of each bank on the fifteenth and last day of each month: on full days there are four clearings per day, usually at 9:15 and 11:30 a. m., and 2:15 and 3:15 p.m., and on half days (Wednesdays and Saturdays) there are two at 9:15 and 11:30 a.m. Clearances outside Pretoria (except at Johannesburg, Cape Town, Durban, Port Elizabeth, and East London where the branches of the Reserve Bank act as the clearing houses) are taken over by one or the other of the commercial banks and proceed on exactly the same lines as in Pretoria except that monthly payments are made in gold or Reserve Bank notes. Country branches effect their own clearances; and

the balances of their local branches together with the quarterly balances of the country branches are taken over by the Head Offices of each bank which includes them in its final obligation, i.e., the Reserve Bank at Pretoria acts as the Clearing House of all the Clearing Houses and this fact must be remembered in connection with the Pretoria returns from July 1921.

TYPES OF PAPER REDISCOUNTED. In terms of the two controlling Acts the Reserve Bank will only rediscount paper which conforms to the following conditions: —

(a) Bills must represent commercial or agricultural transactions.
(b) There must be two names to the bill.
(c) The currency must be not more than 90 days, except in the case of agricultural bills which may be of a currency up to 6 months.

The rediscount rate is supposed to be 1% to 1½% less than the official rate, which is

5½% for bills not exceeding 3 months;
6% for agricultural bills of maturities between 3 and 6 months;
3% for Treasury Bills of 3 months.

Since its inception all the member banks have made use of the rediscount facilities (some banks more than others) particularly at certain seasons of the year when the export trade in wool and maize is being financed, i.e., from September to March, and when as consequence the balances of the commercial banks tend to pile up in London, e.g., the balances in the Reserve Bank at June 30, 1925, were £4,876,000 and at September 30, 1925, £6,435,000, domestic bills discounted by the Reserve Bank being £37,002 (August 28, 1926) and £889,954 (December 4, 1926). Treasury Bills outstanding at January 29, 1927, amounted to £377,998.[7]

[7] According to the Treasury, the total bills issued and outstanding on Jan. 30, 1927, amounted to £10,027,575, of which amount £2,775,675 had been issued to Government Departments, £3,026,000 to the Banks, and £4,225,900 to the public.

Fiscal Functions and Relation to the Government. Until beginning to issue notes the business of the Reserve Bank was chiefly confined to granting advances to the Government on Ways and Means account and on July 29, 1922, loans to the Government totaled £2,200,000. The figure has fluctuated considerably: it has been as high as £2,700,000 (June 28, 1924), but the latest figures available (December 11, 1926) show nothing whatever under this head though the Bank to a limited extent still buys and sells Union Treasury Bills. So far the Bank has not undertaken the flotation of any Government Loans or Securities, and indeed till quite recently it was not even the depository of Government funds. Following the recommendations of the Gold Standard Enquiry Commission (1925) as already mentioned, these have now been transferred from Barclays Bank and the Standard Bank. The chief accounts taken over are the Railways and Harbors Administration Accounts, Exchequer and Paymaster-General's Accounts, the Revenue Accounts (such as Inland Revenue, Customs and Excise and Post Office) and the Account of the Public Debt Commissioners. Government deposits are made and Government drafts are cashed at points at which the Reserve Bank is established; at other points the elaborate branch systems of the commercial banks are utilized. This transfer is an important one for big accounts are affected (Government Deposits at September 30, 1926, in the commercial banks totaled £4,631,000) and it will undoubtedly improve the power and prestige of the Reserve Bank (though the two commercial banks will apparently suffer no diminution in profits because there is no short loan market). The transfer also means for the Reserve Bank a higher gold reserve in respect of these Government deposits — 40 per cent as against 4 per cent previously. Payment of taxes takes place towards the end and the beginning of the year and at such times, therefore, in future, the control of the Bank will be more effective. It is possible that the banks previously lent Government deposits in London: and the transfer lessens the amount of credit available, because, owing to the lack of suitable paper, the Bank's advances in South Africa have so far been very small.

Discount Policy and Methods Used to Control Credit. Under Section 12(3) of the 1920 Act the Bank is obliged to

" fix and publish from time to time the rates at which it will discount the various classes of bills." The first announcement, made on December 29, 1922, fixed the following rates: —

> 6 per cent for first-class commercial bills of not more than 90 days' currency.
>
> 6½ per cent for the first-class agricultural bills with a maturity exceeding 90 days but not exceeding six months.

These rates were lowered by ½ per cent in each case from November 21, 1924, and they have remained at these figures, 5½ and 6 per cent, respectively, ever since. The agreed rates quoted by the commercial banks for first-class paper such as the Reserve Bank is permitted to deal in, are the same as those quoted by the latter, though the Bank's rediscount rate is, of course, considerably lower. How far market rates are influenced or controlled by the Reserve Bank discount rate it is impossible to ascertain, but it is interesting to note that the minimum advance rate previously quoted by the other banks and which may be regarded as corresponding to the discount rate for the period before the Reserve Bank quoted a rate (and in a period comparable with the present) was 6½ per cent (Coastal 6 per cent) on February 2, 1913, so that the competition of the Reserve Bank has had apparently an appreciable effect in reducing rates. At the same time the amount of discount business which it does in the Union is negligible — bills discounted by the commercial banks at September 30, 1926, totaling £22,073,000, and by the Reserve Bank at December 11, 1926, only £706,030. The reasons are that the supply of high grade commercial paper is very limited and the commercial banks with their huge resources and elaborate branch systems are in a better position to serve the commercial community than the Reserve Bank. The changes in law recommended by the Kemmerer-Vissering Report already noted (which will probably be introduced this Session) may improve the position of the Reserve Bank in this respect though they cannot make much difference: and this is particularly true since the absorption of the National Bank by Barclays, with its enormous resources and world-wide connections.

Discounting Done in London. *Most of the Bank's discounting has so far been done in London, and " Foreign Bills Dis-*

counted" totaled £4,929,624 on December 11, 1926. What influence the Reserve Bank has exercised so far has been through its control over exchange rates, which will be dealt with shortly. It must be remembered, also, that the Bank has been too recently established to draw any definite conclusions; that so far there has been no need for it to control credit expansion, since during the greater portion of its existence South Africa has been experiencing a continuous period of necessary deflation. How far it could exercise a restraining influence during a period of credit expansion remains to be seen, but some indication of this is given in the following paragraph.

Open Market Operations and Control of the Foreign Exchanges. It is well to state that there is no money market in South Africa in the sense in which the term is understood in the important commercial countries of Europe and America. The classes of paper to which open market operations of the Reserve Bank are restricted come under two general heads: acceptances and Government securities, and the special conditions governing these particular instruments have been already indicated. The position with regard to acceptances and the alterations in law proposed by the Gold Standard Enquiry Commission and their possible effects, have been dealt with. Open market operations to date in this class of paper have therefore been practically negligible and it is safe to say that under normal circumstances the Reserve Bank by this means could do very little to control the credit situation. Dealings in Government securities have been on an equally small scale — Union Government Treasury Bills under discount at December 11, 1926, being only £183,548 and British Government Treasury Bills only £1,645,000, though the figures have fluctuated considerably so that the sale of such a small volume would scarcely incommode the commercial banks in the slightest.

Control of Credit. Perhaps the most important weapon in the control of credit and the foreign exchanges which the Reserve Bank has is in its purchase of the complete output of gold of the Rand Mines, about £40,000,000 per annum, though it is understood that this right at present extended only till September 1927. The Bank buys the gold bills from the Chamber of Mines, advancing them in South Africa and receiving credit in London. These

bills are frequently bought by the commercial banks from the Bank, in which case the Reserve Bank's London balances run off and those of the commercial banks increase. In this matter the latter are really obliging the former, since normally they have considerable balances in London through their finance of the export trade. The import of specie in South Africa is now negligible while the export is very great indeed, and what movements there are between South Africa and London are very definitely controlled by the Reserve Bank, the cost of shipment being about 12/6 per cent. At the same time the commercial banks export annually large amounts (roughly £5,000,000 per annum in the last five years) to India and the East at a rate more favorable than that charged by the Reserve Bank, in order to balance their exchange position.

Moreover, there is fairly strong evidence that so far as exchange rates go the Reserve Bank is now in a position to enforce its quotations. The monthly Bulletin of Statistics, issued by the Statistics Office, for January 1926 contained the following: —

> "An interesting situation has arisen in connection with the South Africa-London exchange rates. Up to November 30, 1925, the Reserve Bank and the commercial banks quoted the same rates for Telegraphic Transfers (T.T.). But on that date the commercial banks lowered their T.T. rate by $\frac{1}{8}$ to $\frac{1}{8}$ discount whereas the Reserve Bank rate remained stationary at par. As the Reserve Bank time rates were already based on a lower interest rate than those of the other banks, this means that an exporter discounting, for instance, a 90-days' bills with the Reserve Bank would receive $\frac{3}{8}$ per cent more than he would have obtained from the other banks. But on December 21, the commercial banks adopted the same rates as the Reserve Bank, and both for T.T.'s and time bills.
>
> The inference that may be drawn from this episode is that the Reserve Bank now exercises a predominant influence over the movement of the overseas exchange rate and that its avowed policy of reducing interest rates in this country is gradually becoming effective.
>
> "In recent years rates were 1 per cent more unfavorable

to exporters at the end of the year, when large exports of wool, etc., take place, than in the middle of the year. This year (1925) the seasonal movement amounted only to $\frac{5}{8}$ per cent on the rates of the commercial banks and $\frac{1}{2}$ per cent on the rates of the Reserve Bank. If the movements which took place in consequence of the shipping strike (October 1925) are ignored, the movements are still smaller, viz., $\frac{3}{8}$ per cent for the commercial banks and $\frac{1}{4}$ per cent for the Reserve Bank.

"We have already indicated one cause for this favorable movement in rates. But it must also be borne in mind that the restoration of the gold standard has greatly facilitated this movement to cheaper rates. The divergence between British and South African currency cannot be substantially greater than the cost of shipping gold from one country to the other, and thus the reduction in the margin between buying and selling rates from $\frac{7}{8}$ to $\frac{1}{2}$ — a reduction which has probably already saved the South African public over £100,000 — was speedily and easily brought about very soon after the restoration of the gold standard. Moreover, it is obvious that unless the gold standard were in force the Reserve Bank would have continued to find it as difficult as it did before the restoration of the standard to obtain and maintain any effective control over rates, whether of exchange or discount."

Efficiency of Reserve Bank. In estimating the efficiency of the work of the Reserve Bank it must not be forgotten that it has been in existence less than five years; that it has placed the note issue on a sound basis; that it helped the commercial banks to tide over the difficult deflation period; that, with the support of the Union Government and the Bank of England, it stood behind the National Bank in the exceptional period of March 1923 when its capital was considerably reduced and its credit somewhat impaired; that it has created a large amount of extra credit and has reduced both discount and exchange rates. On the other hand, in proportion to the work done, its salary bill seems excessive. If, therefore, it has not completely justified the high hopes held of it, its deficiencies are not impossible of correction. The axiom of Bagehot that "Good banking is made by good bankers and not by good laws" is still true.

CONCLUSIONS

The outstanding features of South African Banking during the last decade are, thus, a continuation of the consolidation process to the extreme, the establishment of the South African Reserve Bank, and the agitation for a State Bank.

COMMERCIAL BANKING. The state of affairs into which banking has been brought as a result of this amalgamation process, is shown by the following table: —

	Total Assets December 31, 1925[8]	Banking Offices 1925
British Banks		
Standard	£59,992,339	280
National (Barclay's)	38,728,642	317
	98,720,981	597
Netherlands' Bank		
Netherlands	3,393,328	17
South African Banks		
Stellenbosch	327,800	1
Colonial	622,974	8
Total for all Banks in the Union	£103,035,083	623

Thus, roughly, 99% of South Africa's banking is in the hands of companies having their headquarters and management overseas, naturally assisted by General Managers in the country, and in one instance at least by a local board of directors.

As we have seen, the Government has no control whatsoever over the organization and administration of banks in the country; not even in the case of merger is its consent necessary. All it can demand under present circumstances is the publication of statements and the maintenance of the necessary reserves with the Reserve Bank. For the rest, there is free banking, free in every sense of the word. Whether such a state of affairs is desirable is subject to grave doubt. When two banks alone, be-

[8] i.e., just prior to the merger of the National with Barclay's.

tween them, do roughly 97% of the country's total banking business, the country, and more especially its Government, can never look upon losses or even possible failures with indifference; yet it has no control over their administration. The country's experiences after the 1920 depression, in the case of one of the banks, has definitely established the fact that, under present conditions, there is a premium on bad banking in South Africa, since in that instance the Government was actually called upon to lend its credit to the institution in question.

Obviously, more supervision is absolutely imperative. It is accordingly most regrettable that the Bank Bill of 1920, which at all events would have brought about uniformity throughout the Union and in addition would have provided for considerably more control, should have been dropped in favor of the Banking and Currency Act of 1920, which concerns itself primarily with the Reserve Bank. The Government will no doubt have to pay a little more attention to this subject in the near future, and provide the necessary legislation for the proper regulation and control, not only of the banks, but of all financial institutions in the country. It should also earnestly consider the developments in its sister Dominion, the land of democratic banking — Canada — which a year or two ago found it necessary to create the position of Inspector General of Banks for the purpose of exercising greater control over the banks.

The Reserve Bank. As we have seen, the establishment of the Reserve Bank took place, no doubt to the detriment of the country, only after the storm was over; and unlike the American Federal Reserve Banks and the Commonwealth Bank of Australia, it could not avail itself of the business and profits of the war and post-war boom period. As has been aptly stated: —

> "Born in a time of financial stringency, disowned by the banks, unutilized by the Government, its functions completely misunderstood by the public, it is not surprising that the South African Reserve Bank has been so far a somewhat ineffective institution."

Of late, certain efforts have been made to remedy the situation. Several branches have already been established, while several

more are contemplated, and only since January 10, 1927, has the Bank begun to act as Government Banker, a function which ought to enable it to exert a little more influence in the future. These changes, it should be observed, are in accordance with the recommendations of the Kemmerer-Vissering Commission on the Resumption of Gold Payments (January 8, 1925). The Commission, however, was very emphatic in pointing out the impossibility of the Reserve Bank acting purely as a bankers' bank, under the peculiar conditions of the country, and urged a slight widening of its scope and powers, to enable it "to serve the public" and to earn its necessary income. Though a bill along these lines was definitely announced as forthcoming at the 1925 session of Parliament, yet it did not make its appearance. It is sincerely to be hoped that, after obtaining the advice of these two experts, each eminent in his particular field, the one in currency and the other in banking, the Government will avail itself thereof, and the Reserve Bank will be enabled to perform those functions and play that rôle in our financial organization for which it was primarily established.

The State Bank Agitation. The State Bank Agitation dates back to the post-war depression, when the banks adopted a drastic policy of deflation. Since that time, the Labor Party has been insistent in its demands for a hundred per cent government-owned-and-controlled State Bank along the lines of the Commonwealth Bank of Australia. At the elections in 1924, before General Hertzog came into power, he promised to have an enquiry made into the subject before committing himself. An enquiry was actually made by Dr. Vissering at the request of the Minister of Finance, and his findings are embodied in a special report addressed to the Minister, "Upon Certain Aspects of South African Banking and Currency."

Although some members of the Cabinet have given the agitation their hearty approbation from time to time, the Minister of Finance has openly declared himself against the scheme, so that there is little prospect of a State Bank being established as long as he holds his present portfolio. It is obvious, of course, that what the laborer wants is not commercial credit but consumptive credit, and were it not for South Africa's small white population, one might therefore succeed in getting these advocates of a State

Bank interested in the Labor Bank movement instead. At all events, the People's Banks already referred to are meeting the needs of the laboring man, and will probably do so even more in the near future, when more reasonable counsel may prevail over party platforms.

The State Bank Agitation, however, is only a part of the ever-increasing demand for Government control and operation. The Land Bank is already a fully Government-owned-and-controlled institution. The State Bank has been demanded for some time now, and of late another agitation is afoot urging the establishment of a State Industrial Bank. The matter has been referred by the Government to the Board of Trade and Industry, but there would not seem to be any undue enthusiasm for the scheme. Somehow, the tendency in South Africa to-day is for the individual to dream and scheme and to leave the carrying out to the Government. If this tendency persists, there will be danger of returning to the conditions prevailing in the early days of the Cape, when the Government monopolized practically every profitable profession, — banking, surveying, conveyancing, transferring slaves, printing, and auctioneering, "to the injury of numbers with little to gain to itself." But a reaction set in at the time, and in these days of cycles it is still possible to look forward to the day of the reawakening of private initiative when people will again realize that he is best served who serves himself.

CHAPTER XV

THE BANKING SYSTEM OF SWEDEN

BY

HILDING MELIN [1]

AN HISTORICAL SURVEY

THE FIRST BANK IN SWEDEN. After the pattern of the Continental "Giro" Banks, principally the Bank of Amsterdam, the first bank was founded in Sweden as far back as 1656. The conditions embodied in the charter testified to the Government's intention to exercise a strong influence upon the bank. The bank was allowed to grant loans against securities, mortgaged property or pledges and was permitted to receive money on deposit against which checks (at that time called bills of exchange) might be drawn. Though the charter did not contain any provision as to the issuing of bank notes, as early as 1661 the bank began issuing notes, thus being the first bank of issue in Europe. Some years later, the bank was forced to discontinue its operations under private charter, as it was unable to meet its obligations. It was at the same time reorganized, under the direct ownership of the State.

Although the present Swedish "Riksbank" is a direct continuation and expansion of the first Swedish bank, it is not correct to say that at that early time the bank was a "central bank" in the modern sense of the term. On the contrary, it may be said that the present Riksbank was the first Swedish commercial bank, as the activities of this State banking institution, which were resumed in 1668, were in many respects similar to those of the modern commercial bank. It was expressly prohibited from issuing bank notes — contrary to its privately conducted predecessor — and the transactions were based upon extensive de-

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posit business, the resultant resources being used for important lending operations all over the country.

Later, as a State institution, this bank again encountered difficulties and in 1709, experienced a crisis with which it was not prepared to cope. During the following decades, the bank was incapable of taking any fresh initiative, and its operations came virtually to a standstill. Later the bank resumed its activities along new lines, the deposit transactions were discontinued, and the issuing of bank notes now became the principal activity. This institution originally chartered as a private bank in 1656, reorganized as a State institution in 1668, is now known as the "Riksbank" of Sweden, thus being the oldest central bank in Europe, with the exception of the Bank of England.

An Attempt to Establish Private Commercial Banks. For nearly a century this State banking institution, then under the name of the Estates of the Realm Bank, ("Riksens Ständers Bank") was the only bank in Sweden. Consequently the demand for business and private credit had to be satisfied by wealthy individuals, by money-lenders, and commercial houses in the open market. Towards the end of the 18th century, however, the need was felt for financial institutions which could serve the country's growing industry, trade and commerce on a larger scale than was possible for the existing State Bank and for individuals to do. Thus quite independently, and almost without any precedent from foreign countries, the first real commercial banks were founded in Sweden, viz., the "Discount companies." Through these new institutions the credit transactions were conducted on quite different lines from those of the old state institution. The discount companies came to be of great importance in many respects. They conducted what were for those times very active deposit transactions and they were the first institutions to show an interest in short credits based upon a nominal guarantee. Unfortunately all passed away during the economic crisis which swept over Europe after the Napoleonic wars. Thus the old state institution again became the only bank acting on behalf of the business life of Sweden.

The Founding of the Modern Commercial Bank: "Enskilda" Banks. The Napoleonic crisis not only affected Sweden's private banks but it also reduced the monetary and finan-

cial system to a depressed state that discouraged the establishment of new banking institutions. The public and business community had to resort to the State Bank or to the open market in order to obtain the necessary credit support. The period during which the present commercial banks were organized is more or less coincident with the reform of the Riksbank in 1828–1830 and the reconstruction of the monetary system in 1834, which together combined to stabilize monetary conditions after several decades of confusion. As early as 1824 Parliament had passed a Bill permitting private persons upon special application to establish credit and banking institutions. Some years later, in 1830, the first modern commercial bank was chartered, based chiefly upon the Scottish banking system, as the share or "lot" holders had to assume personal liability for all the commitments of the bank. It is noteworthy that while the Bank Law of 1824 did not permit the banks to issue notes, they did so without permission. Finally the Government had to concede to them the right of issue, and thereafter the banks based their activities mainly on their note issue privilege. During the succeeding years a number of similar "unlimited liability banks" or "enskilda" banks were founded throughout the country. They were all of a local character, organized for the purpose of serving a particular province or commercial district. Strangely enough they were not located in the capital of the country, but in particular districts or provinces, where the banks opened a number of branches which connected their respective localities with the head office. As mentioned above, these original banks based their activities mainly upon the issuing of their own bank notes, a procedure which was considered at that period indispensable for banking business. In fact the banks received very wide powers in the issuing of bank notes. However, as Sweden had a metallic monetary standard, her price level had a fixed relation to international currency values, and only a limited and fixed amount of notes could circulate in the country. As the number of issuing banks increased more rapidly than the demand for means of payment, it became clear to each that their most serious concern was to keep the notes steadily outstanding, which they had succeeded in forcing into general circulation under mutual competition.

Joint Stock Banks. Gradually, however, it became evident that the deposit transactions, which had earlier been so neglected, were of primary importance. An endeavor was made, therefore, to take advantage of the experiences of deposit banks in other countries, and to introduce into Sweden more convenient forms for the extension of credits to the business community. Banks with limited liability on the part of the shareholders and without the right to issue notes had their origin at this time. The first institution of that kind was founded in the year 1863 and took the form of an ordinary joint stock company. Very soon other institutions of the same character were chartered and in 1886 a law was passed to determine the juridical position of these joint stock companies as banks.

In recapitulation it may be said that from the very beginning the commercial banks of Sweden consisted of two different kinds: viz., the " enskilda " banks, private institutions with the right to issue their own bank notes and with unlimited liability on the part of their shareholders, and the joint stock banks, " aktie " banks, without the right to issue notes and with the liability of the shareholders limited to the amount paid in as original capital.

Thus the present types of commercial banks in Sweden date as far back as 1830. However, their activities were of little importance during the first 30 years, and consequently the stream of credit flowed to a large extent outside the banks instead of through them. These conditions were changed between the years 1858–1873, during which period the banking system was entirely reformed. The issuing of notes gradually decreased and modern deposit business came more and more into practice. The modern commercial banking business of Sweden originated, therefore, about 1870, coinciding with the industrial revolution.

The Riksbank and the Currency System. The silver standard, reëstablished in connection with the reconstruction of the monetary system in 1834, was abandoned in 1873. At that time the gold standard was adopted as the basis for the monetary system in Sweden; the unit being ten " kronor " in gold. One " krona " is divided into one hundred " öre." The mint par of exchange with the dollar is $1 = 3.73 kronor, or 1 krona = 26.799 cents.

The Riksbank and the Issuing of Bank Notes. It has been

mentioned above that the old State Bank was originally the only institution which issued bank notes in Sweden but that after the modern "enskilda" banks were established in 1830, another type of bank note was issued by these banks, originally with self-assumed power but later with legal authority. The number of issuing banks increased rapidly — in the year 1880 there were 28, a maximum number — and the volume of notes in circulation also increased. As many countries had centralized the right to issue notes in one single institution, Sweden eventually followed their example and invested the sole right of issue in the Swedish Riksbank in the year 1897 when a new banking law was passed, regulating the central bank. The Riksbank had been gradually developing into a modern central bank and it was therefore found necessary to revise its regulations. However, as the notes of the "enskilda" banks could not be retired immediately, the latter banks received permission to extend the period for the retirement of their notes to 1904. As compensation for the lost right of issue the "enskilda" banks received the right to rediscount bills with the Riksbank at a favorable rate and to receive loans from it, which privilege gradually diminished, and lapsed entirely at the end of 1910. It may be mentioned that during a period of about 70 years the "enskilda" banks had been issuing their own bank notes, some of which were accepted as a means of payment even outside of the boundaries of Sweden, and so wisely was this right exercised by the note-issuing banks that no note ever lost its value.

In connection with the centralization of the note-issuing authority in the Riksbank a new Commercial Bank Act was passed in 1903, but this was superseded by the Banking Act of 1911, which with a number of amendments is still in force.

CREDIT INSTRUMENTS

In modern economic communities, where commercial life has developed on much the same principles, the methods of effecting payment are on the whole quite similar. Of course there are national characteristics and peculiarities prevailing in the different countries. In the case of Sweden these may be said to be

the relatively slight development of the check business, the prevalence of the Bank Post Bill system, and, generally speaking, the absence of " one name " credit instruments.

Bank Notes. Although the Swedish banking system is of a high standard and has kept pace with modern developments, the bank note is nevertheless still the most frequently used means of payment. Gold has never circulated for general business purposes, although gold coins are the standard coinage of the country. The Riksbank's notes have been redeemable against gold ever since 1873, with the exception of certain years during the World War and postwar period. Gold coins and the Riksbank's notes are legal tender up to unlimited amounts. Small coins, on the other hand, are legal tender to unlimited amounts as towards the State, but as between private individuals or concerns only up to limited amounts. However, this rule has no practical significance.

Checks. In comparison, principally with Anglo-Saxon custom, checks are employed to only a small extent. Sweden is now, so to speak, on the threshold of the development of the check system, and it seems that checks are still being largely used as orders on a customer's own bank account and less often as an actual means of payment to a party other than the drawee.

According to the Swedish Check Law of 1898, a check shall contain, besides the ordinary particulars, the word for " Check " expressly introduced into the text. In the Anglo-Saxon countries this is not an essential item. The Check Law differentiates between a " local " check, which is payable at the place where it is issued, and a " distance " check, which is payable elsewhere than at the place of issue. In order to preserve the right of recourse against the drawer and transferer, a local check must be presented at the latest on the 3rd day after issue if the remitter is a resident at the place of payment, otherwise not later than on the tenth day. A distance check shall be presented at latest on the tenth day after issue if the mail between the place of issue and the place of payment does not take more than 5 days, in which case a respite of 5 days is allowed beyond the time which the mail takes. On the other hand the time of presentation does not affect the drawee's liability to pay.

In contrast to the provisions laid down in the penal laws of several other countries, there are no regulations in Sweden in

regard to particular penalties in the case of criminal overdrawing a check account. According to Swedish Law this is treated as fraud. It would certainly be an advantage if the penal laws laid down special regulations.

Bank Post Bills. One of the main causes of the small expansion of the check system in Sweden is no doubt the use of Bank Post Bills. A bank post bill is a sight bill drawn by a bank on itself, by a branch office on the bank's head office or by a bank on another bank. The banks issue bank post bills against cash payment for any odd amount and take no compensation for doing so. By an agreement between the banks, the bank post bills are honored without any special collection charge, with the result that they have become for the public a convenient and cheap means of payment, especially for transactions between different localities. The bank post bill system introduced in the fifties is peculiar to Sweden, though it is utilized to some extent in Finland.

The instruments dealt with above — bank notes, checks, and bank post bills — are used mainly for the settlement of payments in cases where there is no interval of time, or practically none, between the actions of the two contracting parties; they are thus pure means of payment.

Bills of Exchange. The bill of exchange has acquired its immense importance in the commercial world through the qualities that have been ascribed to the bill of exchange by law and which may be classified in three main groups.

Thus, the bill must fulfill certain strictly formal conditions and must be issued in accordance with fixed regulations in order to acquire the character of a bill of exchange. In the second place, a rightful holder of a bill has the right to claim payment of a due bill, and if payment is refused, to protest the bill, and after he has obtained judgment on the bill, to get payment by serving a warrant of distress. Thirdly, a bill of exchange is transferable with liability on the bill, i.e., that all parties who have previously signed their name on the bill become jointly and severally liable vis-à-vis a rightful holder.

In all essentials the above-mentioned legal qualities of a bill of exchange are quite similar in the different countries, although there are of course slight differences.

Bills of Exchange Act. The Swedish Bill of Exchange Act of 1880 prescribes that the word for "Bill of Exchange" shall be expressly introduced into the text of the bill, which however is not required in the case of bills of exchange issued, for instance, in the United States. Otherwise the formal regulations laid down in the Swedish Bill Law do not differ from those of other countries. The holder of a bill which has not been accepted must present it to the drawee for acceptance not later than six months after the date of issue if it is drawn on any place in Europe, and otherwise at latest one year from the date of issue. When it is presented, the drawee is bound to give an answer within 24 hours. If a bill is not paid on the date of maturity the holder of the bill has the right to have the bill immediately protested, but, in order to retain his right of recourse, he need not do so until the second working day thereafter, i.e., on the "third day." When the bill has been duly protested, the drawer and every previous transferer are liable on the bill for six months from the date of maturity vis-à-vis a holder residing in Europe and for twelve months vis-à-vis a holder resident outside Europe. As against the acceptor, on the other hand, a rightful holder has a right of recourse for three years from the due date.

Notes. As has just been remarked, it may seem strange that, with the exception of bank post bills, "one-name" bonds are used only to a limited extent in Swedish commercial life. There is nothing equivalent to the American "promissory note," since the banks are forbidden to give credit or discount obligations without security on only one single name. The nature of the security, indeed, is a matter of greater importance, to the party applying for credit than his own bond. Municipalities, district commissioners, and similar corporations may however obtain loans without other securities than their own bond. The debtor-bond in question is thus not a credit instrument occurring in ordinary commercial life but a loan instrument.

What is probably a peculiarity of Swedish legislation is the fact that a debtor bond, not being a bill of exchange or a bill of lading, issued payable to "a certain person or to order" has the same character as a debtor bond issued payable only to "the holder," so that a bond of that kind is a running bond and therefore need not be transferred in order to be valid to the holder. It should be

pointed out that the Swedish banks do not grant loans against bonds other than those of a running nature.

INVESTMENT CREDIT INSTRUMENTS. SHARE CERTIFICATES. A Swedish share certificate consists of a share-" mantle " or cover and a coupon-sheet. The shares are issued in various denominations, 1-share, 5-share and 10-share certificates, and in large companies in certificates comprising a still larger number of shares. The share certificates cannot be exchanged. They are issued in the name of a certain person and are transferable only through the owner making a transfer in blank in the space provided for the purpose on the inner side of the share-" mantle." The signature need not be witnessed. When a share is transferred to a new owner the fact need not be reported to the Company except in the case of unlimited liability bank-shares and certain insurance companies' shares, as the majority of companies pay dividends on profits against surrender of a coupon without reference to the person recorded as the registered shareholder. As its name implies, the coupon-sheet contains a certain number of coupons for use when collecting dividends. In some cases, but these are rare, the profits are paid out in the manner customary in the United States, viz., by means of checks made out to the registered shareholders. In most cases the dividend is paid in one remittance only, although it sometimes occurs that it is divided into two payments.

The Swedish share certificates are always rated at a certain par value. The more recent form of share certificate without par value is prohibited by Swedish law. There are of course both common shares and preference shares — the latter either " cumulative " or " non-cumulative."

Finally it should be mentioned that the Swedish Law prescribes that, of shares in Swedish companies owning real estate or engaged in the mining industry, not more than one-fifth may be owned by a foreign subject or, if the company has shares with different voting-power, only so many shares that the number of votes represents less than 1/5 of the number of votes represented by the total shares of the company. This regulation was made in 1916 with a view to preventing real estate in Sweden from passing into the hands of foreigners.

BONDS AND SIMILAR INSTRUMENTS. Unlike a share-certificate, a bond is a typical investment credit instrument, issued for the

purpose of procuring capital. Swedish bonds are always issued in the name of the holder and, unlike American bonds, cannot be registered, either as regards capital or interest. There is, however, a similar method of procedure in cases where the National Debt Office receives into safe-keeping free of charge certain Government bonds, and the General Mortgage Bank of Sweden its own bonds for the same purpose. The owner then receives a certificate showing that he has deposited the bonds in question, and the interest is sent to the depositor or otherwise disposed of as he may desire. The interest on Swedish bonds is paid half-yearly against surrender of the interest coupon for the period covered. Bonds are generally issued in denominations of Kr. 1,000, 5,000, and 10,000. Bonds intended for the Swedish market are seldom issued for lower amounts than Kr. 1,000.

The security offered for the bond loans of private companies usually consists of mortgages on real property, railway constructions, factory buildings, or debentures mortgaged on plant, etc. Sometimes the security is reënforced by a guarantee. As a general rule the security is deposited with one of the banks participating in the issue, and which then safeguards the interests of the bondholder.

Conversion of Loans. Nowadays, when bringing out a bond loan, the debtor generally reserves to himself the right to convert the loan usually after 10 years. In the case of the bonds of private companies repayment takes place only by means of drawings. There are different methods in the case of Government and municipal bonds, either by drawing or by repurchase on the open market, or else by a combination of these two methods at the debtor's discretion.

In some cases in Sweden there have also been issued so-called "partial prescription certificates" ("partialförskrivningsbevis") — bond-notes which are of the same nature as bonds but differ from the latter in falling due for payment on a certain date given on each note.

Another form of credit instrument, which closely corresponds to the last-mentioned, is the "debenture certificate" (förlagsbeviset). The peculiar feature of this is that there is no security stated and that it consequently rests merely upon the credit standing of the issuing concern. The debenture certificate thus

corresponds to the American debenture bond. In the event of default, holders of such debenture certificates cannot foreclose on any special assets of the corporation, for their only redress is to bring suit as creditors on notes which have been unpaid, and so dishonored. It was only a few years ago that debenture certificates were introduced to the Swedish capital market. A number of banks were in difficulties and suffered from a lack of liquid capital. Since bonds could not be issued by the banks, they had recourse to the above-described form of borrowing. Banks are the only institutions that have issued debenture certificates in the Swedish capital market.

PREMIUM BOND LOANS. It should be mentioned as a curious fact that the Swedish State has during the past few years issued three Premium Bond Loans, the oldest of which however has now been redeemed. Interest on these bonds is paid partly in the form of various worth while prizes assigned semi-annually as a result of drawings, and partly as a bonus falling due when the bonds are redeemed. These premium bonds are thus something between ordinary bonds and lottery tickets. As the premium bonds have been issued only in small denominations of Kr. 50 (about $14) and offer the chance of large gains, their purchase has become widespread even amongst the general public, which ordinarily shows no interest in bond investments.

THE COMMERCIAL BANKING SYSTEM

TYPES OF BANKS. In its original form the Commercial Bank Act of 1911 provided that, in addition to the Riksbank, all types of commercial banking business could be carried on by joint stock banks ("aktie" banks), unlimited liability banks ("enskilda" banks,) partnerships, and private persons. However, an amendment to the Act was adopted in 1918, which excluded private persons and partnerships from doing a general banking business. On the basis of the Bank Act with its amendments the Swedish commercial banks may now be classified as

(a) joint stock banks, and
(b) unlimited liability banks.

Since the note-issuing power was centralized in the Riksbank in 1897, almost the only difference between these two kinds of banks now lies in the liability of the shareholders. The shareholders in the ordinary joint stock banks have their liability limited to their actual holdings of shares, while the shareholders in the "enskilda" banks must assume unlimited liability for all the commitments of their respective banks, independent of the amount of shares or "lots" they own. Both varieties of banks are joint stock companies and engage in similar banking activities. According to the law the unlimited liability of the shareholders of the "enskilda" banks is involved under the following circumstances: if on the liquidation of the banks the assets do not cover the liabilities, the deficiency is claimed from the shareholders in proportion to each one's holding of shares. Should any of the shareholders default, their portions are again divided amongst the remainder according to their holdings. Thus the liability of the shareholder is practically unlimited.

TABLE I

Commercial Banks in operation, 1900–1925 [2]

End of year	Banks in operation		
	"Enskilda"	"Aktie"	Total
1900	26	40	66
1905	22	56	77
1910	17	63	80
1913	14	61	75
1915	14	52	66
1920	11	30	41
1921	11	27	38
1922	10	25	35
1923	10	24	34
1924	10	22	32
1925	10	22	32

Position of Different Banks. From Table I it will be seen that of the Swedish commercial banks the "enskilda" banks

[2] During 1926 one joint stock bank has absorbed another similar institution, and two unlimited liability banks agreed to amalgamate, which occurred in the spring 1927.

number 10 and the joint stock banks 22. It is remarkable that this type of bank with the liability of the shareholders unlimited still exists, but these banks appeared first in Sweden, and it has never occurred during their century-old existence that any "lot-holder" has been called upon to meet the depositor's claims. However, it should be mentioned that no new bank of this type has received a charter since 1893.

The "enskilda" banks still maintain their old provincial character, but many of them have opened branches in Stockholm in order to be in contact with the largest center of finance and credit in the country. On the other hand, the joint stock banks have not so definitely devoted themselves to any particular province, but have in many cases developed into inter-local banks, which more or less completely cover the whole country with a network of branches. There are, however, some purely local "aktie" banks with only one or a few offices.

Bank Charter. From the earliest history of the Swedish banks the Government's permission was required before a bank could be started. The present Bank Act stipulates that a Government charter must be granted before a bank may commence operations, or, in the words of the Act: "the receiving of deposits from the general public on such accounts as customarily occur." If the prospective bank is considered likely to be useful to the community it receives a charter for a term of 10 years, which may of course be renewed. The founders of a joint stock bank or an unlimited liability bank must include at least ten Swedish citizens; the shareholders must number at least twenty in a joint stock bank and at least thirty in an "enskild" bank. As will be discussed later, the 1918–1919 amendments to the Bank Act stipulate that no bank merger may take place or any new branches be opened without the sanction of the Government.

Various Restrictions. The main control over the banks is exercised through the Commercial Bank Act as well as through the by-laws of the banks, which have to contain certain specified regulations fixed by the Bank Inspection Board and which have to be finally approved by the Government. The following are the paragraphs in the commercial banks' by-laws dealing with bank activities:

The Company handles deposits and advances of money and deals in gold, domestic and foreign currency, bills, checks and assignments, as well as bonds and other obligations intended for use in general business.

The Company accepts funds at interest, to be repaid either on demand or else after a certain date or at a certain date after notice of withdrawal. Funds are also received on so-called Savings Account.

The Company has the right to carry on a collection business, to grant reimbursement credit and bank guarantees, to negotiate bond loans and the purchase and sale of real property, exercise Trust functions, receive in custody open and sealed deposits and rent safe deposit boxes.

By special Royal Warrant the Company may also carry on a Stock Exchange commission business.

Loans are granted for not more than six months without right of renewal, or, if real estate has been given as security, at a certain fixed notice of withdrawal, but limited to three months.

Letters of credit, cash credits, and credit in current account are granted for a maximum period of one year.

The funds of the Company may not be loaned out on one name only; nevertheless, a bill issued by a solvent person, payable on another place, may be purchased although no acceptance has been obtained thereon. A municipality or other comparable public institution may also be granted loans without any security other than its own bond.

Accommodation may not be granted in any form whatever either to a member of the board or to a member of the staff otherwise than against a pledge which in itself is found to represent positive security, or through the discounting of bills which are found to be based on actual trade transactions.

A claim must be recovered within one month from the date of expiration unless the board in view of special circumstances finds that an extension may reasonably be granted.

In all cases in which the Bank Act and the by-laws lay down no specific regulations, the banks follow accepted usages.

Thus it is left to the discretion of the banks to decide in what form to keep the reserve against deposits and the size of the reserve, provided however that liquid assets are always maintained at an amount equal to 25% of the banks' call liabilities. Although the Bank Act does not clearly stipulate what kind of assets are liquid, the practice is to count cash on hand, checking accounts with the Riksbank, sight deposits with domestic and foreign banks and bankers, sight domestic and foreign commercial bills and bonds quoted on domestic and foreign stock exchanges. The current liabilities are those payable at sight, namely bank post bills, call loans and deposits from domestic and foreign banks and bankers, sight deposits from the public and unused credits in current accounts. Although time commercial bills do not count as legal reserves, they are considered as a strong practical reserve, as they may be rediscounted at the Riksbank.

As regards loans, there are very few restrictions. The earning assets may consist of investment loans, bonds and mortgages, debentures, call loans or bills of exchange to any amount. There are no restrictions as to the amount of loans any one borrower may receive, and it is left to the bank's own judgment to decide how large an amount it has outstanding on its own acceptances. Real estate may only be acquired for the banks' own premises, yet commodities or real estate that otherwise may not be owned might be taken over by the bank to cover outstanding claims if it were obvious that losses would otherwise be incurred. The Act prohibits a bank from acquiring or receiving as collateral security its own shares, and an " enskild " bank may not receive in that way the unlimited liability shares of another similar institution. On the other hand, the Act lays down that a bank may on its own account deal in gold, domestic and foreign coins, bills, checks, drafts, bonds, and debentures.

Capital and Surplus. A comparison between Swedish and foreign commercial banks shows that relatively speaking the Swedish banks have very large capital resources of their own. The relation between capital and deposits in Sweden is 1/4.2, in England it is 1/13, in Canada 1/7 while the National Banks in the United States show 1/7. From Table II it will be seen that during the last decade the capital resources have not increased

as rapidly as the deposits. It should be mentioned, however, that, in relation to the population few countries show as high a total of deposits as Sweden. The large capital resources, therefore, indicate only that the deposits alone have not been enough to meet the requirements of the country's rapidly developing trade, commerce, and industry.

In its original form the Bank Act of 1911 did not permit the banks to receive deposits up to more than five times their own capital and surplus funds combined, a stipulation which in some cases led to the amalgamation of banks having large deposits with banks possessing relatively larger capital resources. Later on therefore the law was amended and now permits banks with more

TABLE II

Relation Between Capital Funds and Deposits
(Amounts in thousands of krono^

(End of year)

	1900	1905	1910	1913	1920	1925
1. Capital stock and reserves	254,515	387,633	588,035	662,345	1,122,040	822,342
2. deposits	771,805	1,041,712	1,465,068	1,691,988	5,095,337	3,494,410
1. in relation to 2.	1/3.0	1/2.7	1/2.6	1/2.6	1/4.5	1/4.2

than 5 million kronor in capital to receive deposits up to eight times their capital stock, while the original regulation is still in force for the smaller banks. The purpose of this regulation, of course, is to safeguard the depositors, and cannot be considered harsh as compared with, for example, the double liability of the shareholders of the National Banks in the United States. Nor are the depositors protected by means of regulations such as exist in England, where the banks have a strong reserve in the capital, subscribed but not paid in. In the case of the " enskilda " banks, however, the depositors are protected through the unlimited liability provision.

Minimum Capital. The Bank Act also prescribes that the capital stock of a joint stock bank must be at least one million kronor. However, if the bank is to serve a locality having only a small business turnover, the minimum capital may be fixed at half a million kronor. The minimum capital stock of an " enskild " bank is also fixed at half a million kronor. If the capital of an unlimited liability bank is less than one million kronor, the name " folk " bank must be used and when the capital stock is above one million kronor, the title of the bank must contain the word " enskild." Based on the total amount of capital and reserve funds at the end of 1925, the Swedish banks may be grouped as follows:

more than 1 mill. kr. but less than 6 mill.	13	banks
" " 6 " " " " " 18 "	6	"
" " 18 " " " " " 30 "	4	"
" " 30 " "	9	"
	32	"

Further, the Bank Act prescribes that all banks must set aside yearly 15% of the annual profits to a reserve fund until that fund equals 50% of the share capital. The reserve fund may not be used for any other purpose than for covering losses which cannot be met out of any other surplus funds or resources.

Deposits. On account of the relative scarcity of circulating capital in Sweden in relation to the country's need, the banks have always found it difficult to increase deposits. Consequently the banks have endeavored, by granting various privileges in respect to interest rates and length of notice of withdrawal to attract that part of the country's savings, which might otherwise have been invested without the banks acting as intermediaries. Quite a number of different deposit accounts have thus come into existence and the Swedish commercial banks have probably a larger variety of different kinds of deposit accounts than the banks of the English-speaking countries.

Regarding the length of notice of withdrawal, these accounts may be divided into four groups; long time deposits, short time deposits, demand deposits, and savings deposits.

Long Time Deposits. Long time deposits are received on deposit account (" Deposition ") and capital account (" Kapital "). The receipt for money on deposit account is a negotiable docu-

ment. A new deposit certificate is issued for every additional amount deposited, and only the whole amount of a deposit certificate can be withdrawn. The interest is not added to the amount deposited but must be withdrawn twice a year. The " deposition " account is the oldest form for receiving money on long time notice, but as these accounts are inconvenient in several respects, and can hardly be classified as true deposits — rather as loans to the banks — the " kapital " account is gradually superseding the deposit account. On a " kapital " account any amount may be deposited or withdrawn, the receipt is non-negotiable and is merely a notification of the credit entry. Sometimes a pass book is also used for deposits on capital account. Both these accounts are time deposits and are, in general, subject to four months' notice, although occasionally three, six, and twelve months' notice is permissible. It should be mentioned, however, that amounts may also be withdrawn at call, but for this accommodation a certain fee must be paid. The interest is credited at a rate which is generally ½–1% below the official discount rate.

TABLE III

Classification of Deposits

<table>
<tr><th rowspan="2">End of year</th><th rowspan="2">Total deposits (in thousands of kronor)</th><th rowspan="2">Deposit & capital accounts in % of Total</th><th rowspan="2">Savings deposits in % of Total</th><th rowspan="2">Checking accounts in % of Total</th><th colspan="2">Current accounts in % of Total</th></tr>
<tr><th>demand</th><th>time</th></tr>
<tr><td>1900</td><td>771,805</td><td>71</td><td>11.8</td><td>12.5</td><td colspan="2">4.8</td></tr>
<tr><td>1905</td><td>1,041,712</td><td>67.7</td><td>17.9</td><td>10.1</td><td colspan="2">4.2</td></tr>
<tr><td>1910</td><td>1,465,068</td><td>67.1</td><td>19.1</td><td>7.1</td><td colspan="2">6.7</td></tr>
<tr><td>1913</td><td>1,691,988</td><td>65.9</td><td>20.7</td><td>10</td><td>2</td><td>1.4</td></tr>
<tr><td>1915</td><td>1,998,476</td><td>60.3</td><td>21.3</td><td>14.4</td><td>2.4</td><td>1.6</td></tr>
<tr><td>1920</td><td>5,095,337</td><td>56</td><td>18.9</td><td>19.3</td><td>3.3</td><td>2.5</td></tr>
<tr><td>1921</td><td>4,854,135</td><td>58.2</td><td>18.8</td><td>18.2</td><td>1.9</td><td>2.9</td></tr>
<tr><td>1922</td><td>4,325,000</td><td>56.6</td><td>18.9</td><td>14.9</td><td>1.7</td><td>7.9</td></tr>
<tr><td>1923</td><td>3,868,565</td><td>54.9</td><td>19.8</td><td>13.1</td><td>1.1</td><td>11.1</td></tr>
<tr><td>1924</td><td>3,675,489</td><td>54.9</td><td>21.4</td><td>11.5</td><td>0.7</td><td>11.5</td></tr>
<tr><td>1925</td><td>3,494,410</td><td>57.7</td><td>22.3</td><td>10.9</td><td>0.8</td><td>8.3</td></tr>
<tr><td>6/30 1926</td><td>3,507,194</td><td>57</td><td>22.7</td><td>11.5</td><td>0.7</td><td>8.1</td></tr>
</table>

As we see from Table III, the long time deposit accounts have always comprised the largest part of the total amount deposited

with the Swedish commercial banks, and although the amount during the last decade has been slightly reduced, nevertheless about 57% of the total deposits are now on long time notice. The reason for the large proportion of long time deposits is to be found in the slow development of the Swedish bond market. The public has not sufficient confidence in industrial bonds, but still regards bank deposits as the only safe method of investing saved capital. During and after the World War, when the continental investment markets ceased to function, the Swedish market grew rapidly. Statistics show, however, that this development of the investment market had but little influence on the long time deposits, which only slightly decreased. It can therefore be said that the long time deposits in Sweden are intended to be real permanent investments of saved capital. The high rate of interest on these accounts is also a reason for their importance.

Demand deposits, checking and current accounts, call money, amount to only about 12% of the total. The interest rate here is 2½–3% below the interest rate on long time deposits, but is sometimes fixed irrespective of the last mentioned at 1–2%. Such a rate is naturally comparatively high considering the fact that the money may be withdrawn without previous notice. The permanent scarcity of available capital in Sweden has put the depositors in a position to secure high interest rates even on pure demand money. It should be recalled in this connection that the check system is not so much in use in Sweden as in America or in the countries of the British Empire which, however, is the case with most of the Continental countries. In Sweden the check is used more as a receipt for money withdrawn than as a means of payment.

Current Accounts. Current accounts (" löpande ") is a checking account with overdraft allowed up to a certain limit. The item " current account " may appear among the liabilities as well as among the assets in the statement, as some customers may have credit balances and others overdrafts. In order to be allowed an overdraft the customer must offer as security, mortgages, bonds, stocks, etc., or give a name guarantee. Money deposited on current account may be withdrawn either on demand or after not more than one month's notice.

The banks pay an interest rate of usually ½–1% below the

official discount rate on money subject to four months' notice and about 2½–3% below the discount rate on call money. However, customers very often succeed in getting specially favorable rates on checking accounts, and it was not unusual for a bank to have checking accounts running with various rates, from the rate ruling for deposit account down to the usual rate on such checking account. In order to eliminate this practice, the principal banks a few years ago established a new account — the "notice-of-withdrawal account" (uppsägning). Money deposited on such an account is subject to 14 days' notice and the interest rate is about ½% below that paid on savings account. As the amount standing to the credit of such accounts in the official bank statistics is included in the item "current account time money," we have to turn to the statistics published yearly by the Swedish Bank Association to find the amount of such accounts, which is about 7% of the total deposits in the commercial banks.[3]

Savings Deposits. The commercial banks may also receive money on savings account, but in order to avoid competition with the savings banks the total balance on each account may not amount to more than 4,000 kronor, except that accrued interest may be credited over and above that total. The interest rate is about ½–1% below the rate on long time deposits. According to regulations, the customer must give the bank at least one week's notice, but the banks have generally modified this regulation so far that a customer may withdraw each month an amount not exceeding 1,000 kronor without notification.

The savings account in the commercial banks is rather new compared with the other deposit accounts, and although some banks had opened savings accounts earlier, such accounts were not commonly used until after the "enskilda" banks were deprived of the power of issuing notes. It is probable that Swedish banking stands alone in having as much as about 23% of the total deposits placed to savings accounts, the average amount deposited being about Kr. 400. or $100.

[3] In the fall of 1926 an agreement was made between the members of the Swedish Bank Association, whereby during 1927 the existing checking and current accounts shall be superseded by a new "checking account." This "checking" account will thus become real deposit account subject to call, as well as an overdraft account. This arrangement will materially simplify bookkeeping procedure.

In recapitulation it might be said that the deposits are at present divided up as follows:

long time money,	4 months' notice	....	57%
short " "	2–4 weeks' "	....	8%
demand deposits		....	12%
savings accounts,	1 week's notice	....	23%
			100%

Contrary to the American custom there are no regulations in Sweden governing the minimum sum that may be on deposit. A customer may deposit as small a sum as he wishes in his bank and he will always receive interest on the whole amount on all deposit accounts except on checking accounts, where no interest is credited on amounts less than one hundred kronor. Although his account may not pay, the bank reckons upon receiving other business from the customer which may compensate for the loss.

Earning Assets. Although at an earlier period the Swedish commercial banks practiced lending operations as dealers in short credits, they have gradually developed along the lines of the " Continental " banking system, and may now be classified as banks for the financing of industry, i.e., they finance not only current trade but also fixed capital transactions. A very close relation between the most influential banks and industrial enterprises has resulted, which has been accentuated even more since the postwar financial depression. Consequently many industrial enterprises have lost their independence to the banks, and a system of interlocking directorates and active participation by bank directors in the control and administration of the private enterprises has developed. The reason why the Swedish commercial banks have taken up industry-financing may be due to the fact that the public has not given its full support to the rapidly growing industries. The small savings of the public have not been invested directly in industrial securities through the Stock Exchange, but have been deposited in the banks, which have therefore had to provide industry with both working and fixed capital. The absence of any open money market in Sweden for short commercial paper is another reason for the greater use of long term commitments.

Table IV shows that lending operations principally take the form of loans. Although the by-laws of the banks prohibit them from granting loans for longer periods than 6 and 3 months, nevertheless loans actually run for a considerable length of time, as they are granted on the mutual understanding that renewals will be allowed.

Cash Credits. Another form of lending is "cash credit," adopted from the old Scottish banking system. A customer is granted credit up to a fixed amount and has right to draw checks against the account. He pays a fee for the accommodation, generally $\frac{1}{2}$–1% of the total credit, but interest only on such amount as has been utilized at any given period. Cash credits may be granted only for one year at a time, but are subject to renewals,

TABLE IV

Classification of Credits
(Rediscounts included)

End of year	Total Credit Extensions (in thousands of kronor)	Loans in % of Total	Domestic bills in % of Total	Cash credit & current accounts in % of Total
1900	949,669	41.2	35.5[4]	23.3
1905	1,559,101	46.9	34.7	18.4
1910	2,173,814	46.9	31.5	21.6
1913	2,442,032	50.9	28.1	21.0
1915	2,617,021	51.3	29.0	19.7
1920	6,662,646	38.9	36.0	25.1
1921	6,121,576	46.5	29.7	23.8
1922	5,316,506	56.2	24.8	19.0
1923	4,816,667	57.1	25.0	17.9
1924	4,683,771	56.0	26.2	17.8
1925	4,481,166	57.7	25.3	17.0
6/30 1926	4,439,060	57.2	25.3	17.5

and may very often be classified as fixed or frozen credits. Cash credits are gradually superseded by current accounts, which may be regarded as a combination of a checking and a cash credit account.

The collateral security for loans, cash credits, and current accounts may at present be classified as follows:

[4] Rediscounts not included.

against	mortgages	41%
"	shares	32%
"	bonds or debenture	11%
"	name guarantees	16%
		100%

Fixed Capital Financing. From the very large proportion of mortgages we may fully realize the heavy amount of fixed capital financing which the Swedish banks undertake and as the country has first class institutions for rural and urban real estate credits, we may presume also that the greater part of the mortgage loans granted by the banks represent accommodation to industry. When we add the mortgage loans to the loans against shares and industrial bonds, which are also indirectly industrial accommodations, the rôle of the Swedish commercial banks as promoters of long time industrial credit is still more accentuated. In this connection, it should be mentioned that the Swedish banks do not discount or grant loans against paper of the kind known in the United States as promissory notes. The view is held in Swedish banking circles that it is not good policy to grant credit simply against the reputation of a person or his firm, and therefore the by-laws of the banks stipulate that the customer must add some collateral or surety to his personal engagement.

Short Bank Credits. The short bank credit is in the first place represented by discounts, which at present take about 25% of the total accommodations. However, a large part of the cash credits and the current accounts are also true commercial credits, as the holders of these accounts regulate all their short term transactions through them. Further, it quite frequently occurs that industrial concerns hold as a cash reserve large amounts of bonds, as loans may always be secured with the bonds as collateral. Such loans of course are also true commercial accommodations.

As we have seen, the Swedish banking system is quite different from the American and the British systems. The Swedish banks do not require the principal engagements to be in self-liquidating paper. On the contrary, available resources are principally invested at long term and represent to a large extent the financing of capital reconstructions. Another noteworthy feature of the Swedish banks is that they are constantly " overloaned," as the

total amount of loans, cash credits and discounts always exceeds the total deposits by some 25%. This condition, however, involves no risk in view of the large capital resources of the banks, which consequently make up the deficit. As the cash reserve is also relatively small, the Swedish banks are in a non-liquid condition, as seen from the British or American points of view. In this connection, however, it must be remembered that about 88% of the total deposits of the Swedish banks are on a time basis and that the Swedish banks cannot therefore be exposed to the same demand for cash as banks in which the principal deposits are on a demand basis.

Industrial Finance Functions. It has been mentioned that the Swedish banks belong to the industry-financing type, and although the banks were even before the World War engaged in this business, the war boom extended the banks' industrial interests through direct engagements as well as through the establishing of underwriting concerns. How the bank engagements are otherwise divided up amongst the different industries it is difficult to say, as the statistics of the individual banks on this point are not available. However, " in banking circles " the opinion is held that nowadays loans distribute themselves over different groups of borrowers in the following proportion:

agriculture	10%
commerce	20%
industry	50%
local government bodies, etc.	20%
	100% [5]

Various Activities. During the earlier history of the commercial banks their activities were very simple and but little specialized. Now, however, a bank performs many varieties of transactions. This versatility may be observed partly from the different kinds of deposit accounts, conducted by the Swedish banks, and partly from the many " indifferent " transactions which are handled along with the ordinary banking activities. Thus, for instance, all the larger banks have established trust departments, by which under the banks' guarantee, securities are received in trust or for custody and estates are administered.

[5] " Welin-Berger," Swedish Banking and Industry, Industrial Sweden Gothenburg 1923.

Most of the banks have also opened safe deposit vaults at their head offices as well as at their principal branches, where depots may be rented and sealed deposits left in safe-keeping. Further, the banks collect matured coupons of stocks and bonds as well as called and drawn bonds, receive instructions regarding collections from both domestic and foreign customers and deal in foreign securities. It should also be mentioned that the banks are as a rule members of the Stock Exchange and have special departments for dealing in securities on the Exchange and for issuing bond loans. It may be said therefore of the Swedish banks as it is of the American trust companies, that they are "the department stores of finance," performing banking, fiduciary, agency, and investment functions.

Bond Market. It has been mentioned previously that only in a small degree was the Swedish bond market developed before the World War. The State, the municipalities, the mortgage banks, etc., turned often to foreign markets, principally to France and Germany, in order to fulfill their requirements for capital funds and the Swedish general public did not take part to any great extent in bond transactions. However, the foreign markets closed at the same time as Sweden went through a lively boom period. Incomes increased and the public became interested in investments. Gradually it became possible to find a market for all Swedish issues within the country and eventually the Swedish public began to repurchase large amounts of the older issues, originally sold to French, Swiss, and German investors. This re-export of earlier imported capital came to be a matter of considerable importance. From being an importer of capital Sweden has now become also an exporter. Bonds which at one time used to be issued by private bankers as well as by banks are now more or less completely in the hands of the big banks. As to the purpose of these issues, quite a number are placed on the market for the financing of reconstructions or expansions, although almost as many are brought out with a view to the conversion of floating bank debts. The issue is as a rule made by a syndicate, formed by some of the banks, which buy the new issue outright, in order to place it on the market through their bond departments. Neither the Swedish bond syndicates nor the selling operations of the banks are in any way as elab-

orate as in America, and in this respect, as in most others, the Swedish banks adopt a more passive attitude towards the public.

Private Bankers. It has been mentioned above that in its original form the Commercial Bank Act of 1911 stipulated that banking business could also be conducted by partnerships or by private persons. It has also been mentioned that these private bankers have played only a limited part in the financing of trade and industry. At the outbreak of the war, however, when all kinds of banking business proved to be extremely profitable, a large number of private banking firms were founded, some of them even engaging in deposit transactions. As their depositors were less protected than those of the long-established commercial banks, opposition developed against the private firms, which led to an amendment of the Commercial Bank Act in 1918, whereby partnerships and private persons were prohibited from doing a general banking business. The law looks upon banking business as " the receiving of deposits from the general public on such accounts as customarily occur," wherefore private bankers were deprived of the right to receive deposits. The King may make exceptions to this rule, which has been done in a few cases.

Specialized Business Essential. The private bankers of to-day must therefore devote themselves to a specialized business. They principally buy and sell domestic and foreign bonds on commission, take part in the underwriting of bonds, deal in foreign exchanges, make loans on bonds, stocks, shares and other securities, etc. Some of them have connections with commercial banks and rediscount their paper with them. As the activities of the private bankers are at present so restricted, their proper designation should be that of Stock Exchange brokers or commissioners.

The Swedish Bank Association. As the activities of all the " enskilda " banks were of the same kind and their legal regulations were similar, they met together at a very early period of their existence in order to discuss topics of mutual interest, and in 1880 was held the first meeting of the " Enskilda Banks' Association." Although quite a number of banking problems came up for discussion during the meetings of the Association, the issuing of bank notes and the various problems in connection therewith were the principal subjects that were dealt with. Later

on, when the "enskilda" banks ceased to have the right of note issue, the joint stock banks were also invited to take part in the meetings of the Association. In 1910, however, the old Association was dissolved and the present Swedish Bank Association was formed.

Object of Association. The principal purpose and object of this Association is to promote a healthy development of the Swedish banking system and its methods. The managing committee holds monthly meetings and once a year there are ordinary bank meetings for all the members, as well as extraordinary meetings when necessary. At these meetings are discussed matters concerning the banks themselves, and also questions of a more general character affecting the banking and monetary system of the country.

The member banks of the Association have bound themselves to follow the various rates and fees that are fixed by the Association from time to time. Hence the Association has adopted rates for domestic and foreign collections, commission charges for accepting drafts and for issuing various guarantees, charges for opening commercial and travelers' letters of credit, etc. Minimum charges have been laid down for acting as paying agent, for receiving securities in trust or for custody or for renting safes for sealed deposits, etc. The members of the Association have also agreed not to sell to the general public the foreign exchanges that are quoted by the Riksbank, at a rate below the sight selling rate as quoted at any given time by the Riksbank. However, when the members are dealing with one another or where the selling of large amounts is involved, the agreement is not valid. Quite a number of foreign exchange brokers have also associated themselves with the agreement, although they are not members of the Association.

Publications. The Association also publishes reference and other books for the benefit of its members. The Swedish Bond Register ("Svensk obligationsbok") and a list of Swedish Bank Places ("Svenska bankplatser") are issued periodically. The Economic Information Bulletin ("Ekonomiska Meddelanden") is published weekly and contains particulars regarding new bond issues, drawn or called bonds, notification of shareholders meetings, news about the Stock Exchange, current interest rates in

Sweden, foreign discount rates and other information likely to be of interest to the banker. The Association has also worked out forms for various contracts, agreements, promissory notes, etc., which are used by the member banks.

In order further to reduce competition the most influential of the banks have agreed to bind themselves to a special interest agreement, fixing the minimum rates which the members must charge for loan accommodations and also the maximum rates that may be credited on the different deposit accounts.

At the end of 1925 Sweden had 32 banks. Of these as many as 27 belonged to the Association. As the member banks hold more than 99% of the combined resources of all the banks in Sweden the importance of the Association will easily be realized.

THE BANK INSPECTION BOARD. The control of the banks by the State dates from the time when the "enskilda" banks commenced to issue their own notes. In the general Bank Act of 1846 dealing with note-issuing banks there appeared a clause prescribing public control of banks and banking. The regulation contained therein has been subject to repeated modification and the present form dates from 1911 and 1919.

The Bank Inspection Board now receives its instructions from the Government, and the main regulations laid down are thus included in the general Bank Act of 1911. The banks must send in detailed monthly reports to the Inspection Board, which are drawn in accordance with the standard form and must contain details of the assets and liabilities of the bank, the various rates of interest given for deposits and charges for loans and the rates for discounting bills of exchange. These reports are used by the Inspection Board as material for the official reports which the Board issues both monthly and yearly concerning the position and development of the banks.

A Commissioner appointed by the Inspection Board is required to take part in the annual auditing of each bank, and at least four times a year the commissioner must carry out a cash audit at the head office of the bank. Further, he must occasionally compare the reports with the accounts and if any discrepancy is discovered it is reported to the Inspection Board. The Board is entitled to send a representative to the shareholders' meetings or to take part in the meetings of the Board of Directors, and in

certain cases the Board is entitled to call an extraordinary meeting of the Board of Directors or of the shareholders. Now and then the Inspection Board must also undertake a general or more special investigation of each bank. The result of its investigations is communicated to the bank together with the comments of the Board. The Bank Act provides that a bank which has lost 10% of its capital stock must liquidate, and therefore, if the Inspection Board finds reason to assume that any bank has lost that part of its capital stock, the Board can immediately request such a bank to draw up a statement of profit and loss. In the case of grave transgressions of the Bank Act or of the Articles of Association of the company, it is open to the Government to declare the charter rescinded. This, however, has never occurred.

Protection of Depositors. The object of the Bank Inspection Board is to safeguard the interests of the depositors. In performing its functions the Board exercises supervision over the banks and has also an advisory influence upon them.

The expenses of the Bank Inspection Board are met by the banks themselves, each bank contributing an annual fee not exceeding 2/100 % of the total amount of the funds of the bank.

INVESTMENT BANKING

The Investment Bank Act of 1909. The Swedish commercial banks had for many years been prohibited from dealing in stocks and shares on their own account which naturally prevented them from taking an active part in underwriting transactions. With the example before them of foreign banks, especially German banks, aiding industry by carrying out stock transactions, bankers in Sweden began to discuss the possibilities of introducing this system into Swedish banking. An Act was therefore passed in 1909 permitting the organization of investment banks, with the right to take part not only in general banking business but in founding and in reorganizing commercial firms and companies by the purchase and sale of stocks and bonds.

However, no investment banks have ever been founded in Sweden. The legislation of 1909 has been too strict and the business was not found sufficiently attractive after those regulations,

especially as the shares would become totally non-liquid in character, and also because the banks came to take part in the underwriting transactions of the country in a much more simple way than by forming investment banks.

Holding Companies. Quite a number of banks have formed holding companies, either separately or in conjunction with private interests. The holding companies, called " emission companies " had as their principal function to acquire, administer, and dispose of securities and real estate. These companies have nothing to do with the above-mentioned investment banks, as they are incorporated companies without right to conduct a banking business. The interests in the companies are represented by one or more banks, sometimes by the members of the boards of the banks, or by other persons. The commercial banks have thus been able to form companies with small capital which acquire, and pledge with the bank, shares and real estate of much higher value. Underwriting transactions were of course very lively during the boom period of the war and a large number of underwriting or emission companies were formed. In 1920, when the period of prosperity suddenly gave way to one of depression, the underwriting companies were holding large portfolios of shares in old and new companies. Many of these shares turned out to be of little or no value and the underwriting companies suffered enormous losses, many of them being forced to liquidate. Most of their resources were pledged with the banks, which consequently incurred heavy losses. However, the losses of the underwriting companies cannot be simply attributed to poor management, but also to the fact that the companies right from the very beginning experienced a financial crisis, which proved to be one of the severest Swedish trade and industry has ever encountered. The underwriting companies were ruined by the deflation period which prevailed throughout the world in 1920–1922.

Rural Credit Institutions. The mortgage banking idea is a very old one in Sweden. As early as the year 1779 the Riksbank advanced money on both rural and urban real estate mortgages, which was paid back on a three years' instalment plan. Later on the Riksbank discontinued this practice and private mortgage associations were founded. As there was no special legislation under which these associations could be formed, each one had to

obtain individual sanction from the Government before starting operations. The articles of the association had also to be approved by the Government. Up to 1861 eight such mortgage associations had been sanctioned. The competition among them was very keen and sometimes unsound. Each association issued its own bonds and had its own regulations for granting loans, for membership, for calculating the liability of the members, etc. This lack of uniformity and the unhealthy competition among the first private mortgage associations led to the establishment of the General Mortgage Bank of Sweden ("Sveriges Allmänna Hypoteksbank").

The General Mortgage Bank of Sweden is at present administered under an enactment of 1890. It is under state control and has received from the Government 30 mill. kronor in Government bonds as a guarantee fund. The Board consists of five members. The first chairman is nominated by the Government, the second chairman by the National Debt Office ("Riksgäldskontoret"), and the three remaining members are elected by the mortgage associations. The General Mortgage Bank may consequently be considered a semi-public institution. The purpose of the Bank is to grant loans to mortgage associations against first mortgages and to issue bonds secured by these mortgages. Thus the Bank deals only with mortgage associations and its only business is granting loans to the associations and selling its own bonds in Sweden as well as abroad. Since 1920, however, the bank has a safe deposit department, receiving in custody the bonds of the bank.

Few Restrictions Imposed. Very few restrictions are imposed in regard to the granting of loans. The loans are either amortization or straight loans. Amortization loans may be granted up to 50% of the value of landed property and straight loans only to 1/3 of the value. The last mentioned loans are granted for a period of at most 25 years. The amortization loans run from about 30 to 50 years.

The Mortgage Bank issues bonds payable to bearer secured by mortgages on farm land. The associations are jointly responsible for these bonds, each one in proportion to its balance of debt to the Bank.

The statement below shows the total amount of loans granted

by the Bank to the associations, the repaid amounts and the remaining loans up to the end of 1925.

Total loans advanced (1861–1925)..........	Kr. 864,692,000
Loans repaid and amount amortized........	" 526,980,000
Net amount outstanding at the end of 1925....	Kr. 337,712,000

At the end of 1925 the net claims of the associations against farmers amounted to Kr. 337,397,000. The value of the land corresponding to these loans was Kr. 992,578,000, which shows that the farmers had mortgaged their land to the association up to an average of 34% of the value of their farms.

Mortgage Associations. At present there are ten mortgage associations in operation. They are private institutions, but their articles must be approved by the Government. The purpose of these associations is to grant loans to farmers against first mortgages on farm land. Each one is operating within one or more provinces of the country, so that no competition exists between them. In general there are no regulations governing the use of the proceeds of the loans, which consequently can be used for improvements, for repairs, or for repaying other debts.

Only the actual land itself is taken into consideration on a valuation of the property; buildings, forests, and movables are not included. Only borrowers are members of the associations. All are jointly responsible for the liabilities of their association in proportion to each one's unpaid debt.

Urban Credit Institutions. When the General Mortgage Bank was founded in 1861 the owners of town property tried to get the Bank organized as a central institution for granting urban as well as rural mortgage credit. They did not succeed, however, as it was considered that the values of urban real estate were not sufficiently stabilized to warrant State-aided institutions giving credit against such security. Such associations were founded, although quite privately, by real estate owners in cities or similar communities. In a few cities mortgage joint stock companies were formed for granting loans on town property. At present 6 such companies are in operation. The most important is the Mortgage Guarantee Bank of Stockholm (" Stockholms Intecknings Garanti AB "), which grants loans on real estate in Stockholm. This bank ought to be mentioned also because it is the

only mortgage company possessing a right to do ordinary commercial banking business.

However, there eventually arose a new demand for State support in the regulating of urban real estate credit with the result that in the year 1909 the Town Mortgage Bank of the Kingdom of Sweden ("Konungariket Sveriges Stadshypotekskassa") was founded with support of the Government.

The purpose of the Town Mortgage Bank is to grant loans to urban mortgage associations against first mortgages on real estates in cities and similar communities. The bank is under the control of the Government and has received 50 million kronor in Government bonds as a guarantee fund. The Board consists of five members. Four are elected by the Government and one by the National Debt Office. This bank is consequently a semipublic institution similar to the General Mortgage Bank. In the same manner both banks issue their own bonds secured by the loans which the mortgage associations have granted on urban or rural real estate. However, unlike the General Mortgage Bank, which is unrestricted, the Town Mortgage Bank may only issue bonds to an amount equal to at most 10 times the guarantee and reserve funds combined.

Loans to Mortgage Associations. The method of granting loans to town mortgage associations is somewhat restricted. Amortization loans are given only with one half of one per cent or one per cent amortization, and straight loans only for a period of 10 or 20 years. Amortization loans are further granted up to 50% of the official taxation value of the estate, or 50% of the value estimated by the town mortgage association, if this latter value is found to be lower than the official value. In some parts of the four largest cities in the country, however, loans may be granted up to 60% of the value as above. Straight loans are given on stone buildings up to 37.5% of the value figured as above and on wooden buildings to 33%. Only improved property may be mortgaged.

As mentioned, the Town Mortgage Bank deals only with town mortgage associations, which at present number 22. The associations are private institutions formed by the owners of urban real estate within a certain district. The by-laws are approved by the Government. Their purpose is to grant loans against first

mortgages on improved urban real estate within the particular district of the association. Hence there is no competition between the different associations. Loans are granted on the same conditions as loans from the Town Mortgage Bank. At present the urban associations are paying proceeds of the loans in bonds of the Town Mortgage Bank instead of in cash. The borrower receives bonds running with the rate of interest he has to pay on his loan from the association. The borrower himself pays the discount or receives the premium on the bonds. Further, the borrowers have to stand the general administrative costs of the association, which in general amounts yearly to $\frac{1}{10}$–$\frac{1}{4}$ of one per cent of the amount borrowed.

Volume of Mortgage Loans. At the end of 1925 the net amount of outstanding loans granted by the Town Mortgage Bank amounted to Kr. 385,274,000 and the amount of outstanding bonds to Kr. 399,337,000. The bank has been very successful, which proves the existence of a real need for such an institution.

The owners of real estate have received exceedingly favorable terms for their long time credit through the establishments of the General Mortgage Bank and the Town Mortgage Bank. As these banks are State-aided and semi-State institutions they have been in a position to receive foreign as well as domestic loans under very favorable conditions. Many of the bond issues of these banks have been placed in France, Germany, and Switzerland, and have been quoted on the stock exchanges of those countries.

Savings Banks. On models adopted from other countries the first savings banks were founded in Sweden in the eighteen-twenties. They came into being exclusively through the energy and sacrifices of private persons and without the Government authorities taking any steps whatever to facilitate their existence or to ensure their proper administration. In the beginning their development was comparatively slow, but from the sixties onwards it became more rapid as a large number of savings banks were started. The savings banks quickly won the confidence of the public and at an early stage they proved, both from an economic and from a social point of view, to be of the greatest importance and significance for the country. Gradually the demand arose that the savings banks in Sweden, as in other countries, should be made subject to State control, which indeed was brought

about by the passing of the Bill regarding savings banks in the year 1895. This Bill has since then been substituted by a number of savings banks laws. At the present time their activities are governed by the law of 1923.

This law prescribes that the founders of a savings bank must consist of at least 20 Swedish members resident within the kingdom and that the regulations of the bank must be ratified by the District Governor of the country. The Capital Stock shall be at least 10,000 kronor. The affairs of the savings banks shall be looked after by not less than 20 and not more than 50 trustees, who shall supervise the bank's administration as representatives of the depositors. The trustees elect a Board whose function it is to undertake the immediate management of the savings bank's activities.

The savings banks accept deposits only on Pass Book Account. A depositor's balance may not exceed 30,000 kronor. Funds deposited can only be withdrawn after previous notice of at least a month. However, the Board may allow withdrawal without previous notice, which in fact is done in the case of small amounts. The total amount of deposits may not exceed 50 times the capital funds of the savings banks. From Table V (at top of next page) it will be seen that the total of deposits in 1925 for the 496 savings banks in the country amounted to 2,497 million kronor.

The savings banks invest available funds in mortgages up to 50% of the assessed tax value, in safe bond issues or against loans with positive security in the form of pledges or guarantees. Municipalities, counties, or similar political divisions may obtain loans without other security than their own bond. Loans are granted for one year or at not more than 6 months' notice or else for a certain period not exceeding 10 years and annual amortization. Statistics show that mortgage loans predominate, about 50% of the total lendings, and it seems that the savings banks are one of the more important forms of loan-negotiating institutions in the country for the purpose of raising money on real estate.

Liquidity of Savings Banks. The new savings bank law has also laid down detailed regulations regarding the liquidity of the savings banks, to the effect that the savings banks must account for, in the form of assets that are easily convertible into money,

TABLE V

Savings Banks

End of year		1900	1910	1920	1925
Number of Savings Banks	In urban districts	....	111	149	150
	In rural districts	....	325	336	346
	Total	388	436	485	496
Number of Pass Books		1,228,930	1,560,317	2,270,318	2,497,449
		(in thousands of kronor)			
Total deposits		437,391	808,789	2,023,954	2,488,684
Capital funds		39,534	67,902	112,680	169,414
Total Resources		478,536	879,496	2,144,053	2,670,221
Cash and due from banks		21,857	35,118	75,886	74,383
Bonds		58,474	85,778	430,853	578,630
Loans against mortgages		245,846	493,493	976,858	1,410,791
Loans against name guaranties		86,046	144,484	319,958	289,875
Loans to municipalities		20,383	35,484	128,501	129,149
Miscellaneous loans		29,888	54,667	145,728	96,533

an amount which, when added to the savings bank's cash on deposit, corresponds to at least 10% of the depositors' balances. The law prescribes that the cash reserve must be in the form of credit balances at the Riksbank or domestic banking company, Treasury bills (" skattkammarväxlar ") or bonds issued by the State, the Town Mortgage Bank, the General Mortgage Bank or other undoubted bond loans. Nevertheless, out of the cash reserve an amount of at the most 100,000 kronor may consist of mortgages within 50% of the tax value.

The supervision of the savings banks is carried out by the District Governor in the respective counties, who appoints a general representative to follow the operations of the savings banks with careful attention.

Since the savings banks were founded with a view to encouraging economy and originally came into being practically as an element in the service of the poor relief authorities, they have never served the purpose of producing profit for the founders. The law in fact prescribes that the founders have no right to

participate in any profits that may accrue on the business, but that such profits shall either be funded or utilized for the common benefit.

The Post Office Savings Bank. In order to provide the public with additional facilities for depositing small savings and with a view to serving the numerous places inaccessible to the savings banks, the Post Office Savings Bank was established in 1883. It is at the present time the biggest savings bank in Sweden, with total deposits amounting to about 165 million kronor divided among nearly 740,000 pass books.

TABLE VI

The Post Office Savings Banks

End of year	Number of Post Offices	Number of pass books	Amounts in thousands of kronor				
			Deposits	Cash and due from banks	Bonds	Municipal loans	Mortgage loans
1900	2,652	566,805	56,461	489	46,890	16,334	....
1910	3,245	557,337	46,253	1,605	34,889	10,327	1,245
1920	3,672	661,686	84,356	4,076	63,082	13,364	6,759
1925	3,753	739,067	165,085	7,390	100,820	28,112	32,770

All post offices — over 3,700 — act as branches of the Bank, and deposits and withdrawals on one and the same book can take place at any of these offices. As the Post Office Savings Bank principally aims at securing the smallest savings, it supplies the so-called savings stamps for as small an amount as 10 öre (about 3 cents) for the purpose of enabling one to save the minimum sum fixed for direct deposit in the Bank, viz., one krona. The deposits are received under State guarantee.

Funds are accepted only on "Pass Book Account." The maximum sum allowed on each book is 5,000 kronor. Three hundred kronor may be withdrawn each week without previous notice. In the case of withdrawals involving larger amounts a certain period of notice is required.

The assets of the Post Office Savings Bank are mainly invested in bonds, mortgages, and loans to municipalities and similar corporations.

As will be seen from the statistics, the Post Office Savings Bank did not show a very strong development during the first two decades of the present century, but the last five years have shown a steady increase in the total of deposits.

BANKING DEVELOPMENT 1900–1925

From Table VII showing the statistical development of the Swedish banks we find that during the last 25 years many mergers and consolidations have taken place and many new banks and banking offices have been established. Although 66 commercial banks were in existence at the end of 1900 and some 58 banks have been chartered during the last 25 years, there are at present only 32 banks. Consequently a very large number of banks (107) have liquidated, of which 84 have merged with other banks, 17 have been reorganized, and 6 have gone out of business. From the figures dealing with bank officers (Table VII) we find that from about 280 at the beginning of this century Sweden has now about 1,100 bank offices.

Earlier Bank Mergers and Consolidations. In accordance with the Bank Act, the only limitation on the establishment of new banks has been the Government charter. There were no restrictions before 1918 regarding the opening of branches. Consequently the banks have from the earliest times established a network of branches over different parts of the country. The average number of branches to each bank was about 4 between the years 1880–1900. Mergers are perhaps a more modern method by which banks can develop and enlarge their influence. Practically no amalgamation of the modern Swedish banks took place before the year 1903, but since that time mergers have taken place almost every year. The earlier amalgamations involved only the smaller banks without materially altering the prevailing bank-structure. From the year 1910 onwards, when the two largest banks merged into one institution, of a size hitherto unknown in Sweden, a second period began, ending with the conversion of the old banking system, comprising a large number of decentralized banks, into the modern structure, i.e., a few powerful inter-local banks, covering almost the whole country with a

TABLE VII

Banks authorized to commence business, discontinued banks, banks in operation, bank offices and inhabitants per bank office from 1900 to 1925

End of Year	Banks in operation			During year				Total population of country (in round figures)	Total number of offices	Inhabitants per bank office	End of year
	"Enskilda"	"Aktie"	Total	Authorized to commence business. Excluding reorganized banks	Discontinued banks: Merged with another bank	Discontinued banks: Fully liquidated	Discontinued banks: Liquidated and reorganized				
1900	26	40	66	3	1	.	.				1900
1901	26	41	67	1	.	.	1	5,140,000	281	18,291	1901
1902	25	42	67	.	.	.	1				1902
1903	22	48	70	4	1	.	3				1903
1904	23	48	71	3	2	.	.				1904
1905	22	56	77	9	2	.	.	5,290,000	400	13,237	1905
1906	20	55	75	4	6	.	.				1906
1907	19	61	80	8	2	1	1				1907
1908	18	66	84	5	1	.	1				1908
1909	18	65	83	2	3	.	.				1909
1910	17	63	80	.	2	1	3	5,520,000	584	9,456	1910
1911	15	61	76	1	5	.	1		595		1911
1912	15	63	78	2	.	.	.		616		1912
1913	14	61	75	.	3	.	.	5,640,000	630	8,950	1913
1914	14	53	67	.	7	1	.		659	8,618	1914
1915	14	52	66	1	2	.	.	5,710,000	721	7,923	1915
1916	14	45	59	.	6	1	.		805	7,152	1916
1917	12	41	53	6	12	.	.		1050	5,524	1917
1918	11	39	50	5	8	.	1		1319	4,402	1918
1919	11	32	43	3	9	1	.		1408	4,152	1919
1920	11	30	41	.	2	.	1	5,900,000	1410	4,187	1920
1921	11	27	38	1	3	1	.		1398	4,259	1921
1922	10	25	35	.	3	.	2		1356	4,415	1922
1923	10	24	34	.	1	.	1		1307	4,595	1923
1924	10	22	32	.	2	.	.		1253	4,817	1924
1925	10	22	32	.	.	.	1	6,050,000	1091	5,548	1925

(During 1926 one joint stock bank has absorbed another similar institution, and two unlimited liability banks agreed to amalgamate, which occurred in the spring 1927.)

network of branches, working side by side with some of the long established provincial and local banks.

Causes of Mergers. The principal cause of the earlier mergers was that a bank in difficulties found it more advantageous to accept an offer to amalgamate than to reorganize in one way or another. From what has already been mentioned it will be recalled that the note-issuing right was taken away from the "enskilda" banks between 1897–1904. This was one reason for the many reorganizations that took place during the earlier period. Some of these banks found it desirable to give up their charter as "enskilda" banks when the right to issue notes was taken away from them. Afterwards they organized themselves as joint stock banks. Although most of the banks established during the first decade of this century came into being as a result of the general expansion of trade, industry, and commerce, quite a number of them are only reorganizations of already existing local credit firms, whose activities had grown to such an extent that a banking charter was necessary.

The Modern Process Towards Concentration. As already mentioned, the merger of two of the largest banks in Sweden in 1910 marked a new epoch in the concentration process. This amalgamation showed how a growing bank might outstrip its competitors through means scarcely realized before, and many of the amalgamations of the last ten or fifteen years have had their origin in the banks' natural desire to outdo their competitors. This fact is especially true of a number of amalgamations which occurred during the prosperous years 1916–1919.

Reasons for Amalgamations. Many of the amalgamations after 1910 were a natural result of industrial evolution. After the period of depression immediately following the outbreak of the war, business conditions became active and flourishing, as Sweden entered upon a period of inflation. Commercial firms increased their capital, many industrial enterprises amalgamated and they all expected the banks to support them in their various financial problems. This, however, the banks were unable to do, not being strong enough to render adequate assistance. None of the banks was capable of financing the imports or exports of the large industrial enterprises, which were now developing on a scale that would previously have been considered impossible. Concentra-

tion was thus forced upon the banks by the very evolution of industry. Naturally, this simultaneous growth of industrial and banking enterprises is of great importance, as there is no open money market in Sweden, so that all credit requirements must be met by the banks. Further, the seasonal supply of capital in different districts of the country played a prominent part in this consolidation process. If we view these facts in conjunction with the efforts made by the different banks to surpass their neighbors, and with the fact that Sweden had altogether too many small local banks, we find an explanation of the many mergers and consolidations that took place during this period.

Simultaneously the process towards concentration was intensified by the opening up of new branch offices. It has already been mentioned that even at the beginning the Swedish banks established a few branches, which operated side by side with the head office, and Table VII shows that the number of branches was constantly increasing. Just as in the case of the amalgamations, the opening up of new branches proceeded comparatively slowly in the beginning; during the last ten to fifteen years, however, the increase has become more rapid. The rivalry between the different banks grew and the banks vied with one another in being the first to open offices in every locality that might possibly be in need of banking services. The result was that in every single place that could boast of any business transactions at all, one or more bank offices were opened.

Founding of New Banks. From the statistics (Table VII) we find that during the same period when many banks liquidated, a number of new banks were organized. However, it may be said that there did not exist in Sweden any real need for new banks at this time. In spite of this, a number of them were chartered for such special purposes as they were supposed to serve, one mainly for the farmers, another for the retailers, a third for the laborers, and so on. Although some of these institutions were strong factors in the banking world for some years, they all turned out more or less as failures, not being able to compete with the old-established institutions. At present there are only a few of them in existence. Some of these new banks may also be called "counteractive"; that is to say, local sentiment, which had gradually been opposed to the centralizing of banking institu-

tions, led local interests in a few cases to organize a new bank in place of the one which had been absorbed. A few new banks were also chartered as direct successors to private banking firms when the latter found their activities so curtailed that they were being virtually left outside the general banking business after the passing of the amendment to the Bank Act of 1918, which states that deposits from the general public may be received only by the joint stock banks and the " enskilda " banks.

Bank Liquidations. Between the years 1900 and 1925 six banks were entirely liquidated. One of them wound up its affairs in 1916 only because the shareholders did not like to carry on banking business. On the liquidation of that bank the shareholders were refunded the entire share capital together with a stock dividend of 7 per cent. The other five, however, were all forced to liquidate on account of heavy losses. In two out of these five cases the banks failed and were placed under administration, giving to the depositors in one case 90.5% (in 1910) and in the other only 76.8% (in 1919). One bank, which was liquidated in 1914, was able to pay back its depositors in full, except a small part of the interest due. The two or three banks that were unable to pay their depositors in full were fortunately all smaller banks and the number of their depositors was comparatively limited.

Amendments to the Bank Act. During the years 1917–1919 a feeling of resentment began to arise against the mergers and consolidations of the Swedish banks. This opposition came especially from the provinces, which had lost their old well-managed provincial banks. Local interests pointed out that their legitimate need for credit accommodation was not sufficiently attended to. They claimed that their money was drawn through branches of the big banks to the financial centers of the country, especially to Stockholm, whence it was directed to industrial enterprises of no interest to the local depositors. The risk of having the whole banking business concentrated in a few hands, just as in England, was also emphasized. This sentiment led to the amending of the Bank Act in 1918, whereby it was provided that no branch office could be opened without the sanction of the Government and only when the proposed branch office could prove really useful to the community. Further, in 1919, an-

other amendment was added, which provided that no amalgamations between banks were allowed without the sanction of the Government, which was to be given only if the mergers in question did not seem to be prejudicial to the community. In the same amendment it was prescribed that a bank may not own stocks or shares in another banking concern without special permission from the Government. Thus the mergers have been restricted by law, and although quite a number of amalgamations have occurred since the passing of this law, there seems to be no doubt that this check upon further consolidations came at a very opportune time.

Present Banking Structure. At the beginning of this century Sweden had some 66 commercial banks, which number had gradually increased to 84 by the end of 1908. Although branch banking has always existed in Sweden, most of the banks had found it advantageous to restrict their activities to a certain province, and there was at this time in Sweden no banking institution that had more than a provincial or limited inter-local character. The "enskilda" banks in particular have been regional banks. They had been founded solely for the benefit of a province, opening branches in various places within their districts, thus confining themselves to assisting the economical evolution of their special communities. By and by, however, some of the banks found their way outside their own particular community, and it frequently happened that a developing bank in a remote province opened a branch in Stockholm in order to be directly represented in the financial center of the country. This movement towards banking concentration, which started through the opening up of branches as well as through mergers, was, as we have seen, a natural stage in the evolution of the whole economic and industrial life of Sweden, and was not a result of dissatisfaction with the prevailing system, nor was it from the beginning an effort by the banks to outrival their competitors. At the outbreak of the World War this sound process of bank concentration had not by any means changed the former system. The old established provincial banks were still predominant as a group, but through mergers and the opening of branches a number of joint stock banks had grown into limited inter-local banks, although on a small scale, as they covered a

number of districts or provinces without extending over the whole country. However, this process was followed during the inflation period by an activity hardly credible, and in a few years the concentration movement had attained results that might otherwise have taken decades to accomplish. The old system, with the banking business divided between one strong group of provincial banks and one of local institutions, now changed completely.

Dominant Inter-Local Banks. By the end of 1925 Sweden had 3 very dominant inter-local banks, which cover the larger part of the country with their network of branch offices and handle about 46% of the total banking business in the country. Side by side with them Sweden has a strong group of limited inter-local banks, which deal with about 22% of the banking transactions of the country, while the provincial banks handle some 18%. Hence the local banks, which are still comparatively numerous, take the remaining 14%. However, as Stockholm's Enskilda Bank and Stockholm's Intecknings Garanti Aktiebolag are quite different from the other local banks — Stockholm's Enskilda Bank on account of its size and its dominating influence even outside the boundaries of the country, and Stockholm's Intecknings Garanti Aktiebolag on account of its special activity as a mortgage bank — these two banks should not be included amongst the other local banks, if we are to gain a correct view, as above, of the different types of banks. In Table VIII (see top of next page) Stockholm's Enskilda Bank and Stockholm's Intecknings Garanti Aktiebolag are taken separately, thus showing that the 10 small banks with a purely local interest do not handle more than about 3% of the banking transactions of the country.

Consequently, we find that the change in the banking system, which started at the beginning of this century but which was highly accelerated during the war-time inflation period, has brought about a rather well balanced division between the various groups of banks. In conclusion, it may be said that on the whole the development of the banking system, as it has actually been carried through, has proved beneficial to the country since it would probably have been impossible to meet the economic consequences of the war and the post-war conditions with such success if the banking system had been as decentralized as it was a dec-

TABLE VIII

Commercial Banks

Relations between bank groups as to capital; deposits; total resources, December 31, 1925 [6]

	Number of banks	% Capital	% Deposits	% Total resources	% Average
		of total			
Inter-local banks.....	3	44.7	46.5	47.3	46
Limited inter-local banks.............	6	21.0	22.9	21.2	22
Provincial banks.....	11	16.3	20.1	17.4	18
Local banks ordinary	10	3.7	2.0	2.2	3
Local banks special	2	14.3	8.5	11.9	11
	32	100	100	100	100

ade ago. However, though it is necessary to have a few strong inter-local banks to form the backbone of the banking system, it must be regretted that many of the old-established banks have disappeared, which for decades had exercised their conservative judgment and applied their practical experience to further the prosperity of their particular provinces.

The Banks and Post-War Deflation. After the boom period and the many years of high prices, Sweden entered upon a period of deflation, which from the fall of 1920 to the early part of 1922 scaled down all prices, perhaps more violently than in any other country in the world. From being about 366 in June 1920, the index of wholesale prices declined to about 160 in the spring of 1922. Naturally, such an overwhelming price reduction and revaluation of everything reckoned in terms of money caused the Swedish banks heavy losses owing to the inability of customers to fulfill their engagements. A large number of banks had to write off considerable amounts, and as we find from the statistical development, a number of banks had to be completely reconstructed. The shareholders have in these cases made very heavy

[6] As a result of the amalgamation in 1926 of one inter-local and one limited inter-local bank, the former group of banks handles about 51%, and the latter, numbering 5 banks, 18% of the entire banking business of the country.

sacrifices, but it is only in a few cases that the depositors' money was effected. The total amount that has been written off since 1921 is considerable, viz. —

1921	231 mill. kr.
1922	304 " "
1923	47 " "
1924	40 " "
1925	37 " "
1921–1925	659 mill. kr.

Of this enormous amount about 390 millions have been taken from capital funds already in existence, and some 270 millions from profits made during the period involved.

The Credit Bank of 1922. In order to mitigate the influences of these bank reconstructions upon general business conditions, to prevent losses on the part of the depositors, and also in some cases to prevent banks from having to be placed under administration, the Swedish State, with coöperation of the commercial banks, formed the "Credit Bank of 1922" (AB. Kreditkassan av 1922). This institution was opened with a share capital of 5 million kronor, which was subscribed by the commercial banks, and a State guarantee fund of 50 million kronor in government bonds, which was later increased to 105 million kronor. From the beginning the Credit Bank was organized to support banks that had contracted such heavy losses that they were unable by themselves to carry through a liquidation. The fresh capital required by such a bank was then guaranteed by the Credit Bank, which advanced money against the shares of the reconstructed bank as security up to the par value of those shares. But the Credit Bank also directly took over such amount of shares as was not subscribed by the public or by the old shareholders. Later on, however, the support thus given was found to be inadequate, and the Credit Bank was granted the further right to render assistance through taking over some of the banks frozen or temporarily non-liquid credits.

Support of Commercial Banks. The Credit Bank of 1922 has supported 6 commercial banks (and also a few savings banks) and its total resources, 110 million kroner, now seem to be entirely invested in the shares of these banking houses and also in loans which have been taken over from the portfolios of these

banks. As this institution does not publish any statements and as its affairs are confidential, its results could not be known until the end of 1927, when an official report on its activities was to be presented to Parliament, with a view to finding out how this very interesting official State-supported credit institution has worked, and how much of its resources will have to be written off as losses. This much may be said, however, that the frozen engagements taken over by the Credit Bank belong to such industrial enterprises as in the interest of the whole country ought to receive greater support than the reconstructed banks themselves could have given them. Hence it was more or less certain, that the Credit Bank must occasionally suffer losses, as its engagements had to receive a higher valuation in the portfolio of the Credit Bank than they would have received had they been left with the respective banks under reconstruction. The Credit Bank was fully aware of these assumed risks, which indeed could reasonably be taken, as the institution can afford to postpone the liquidation of its engagements for a number of years. In some cases, after the loans had been turned over to the Credit Bank, the industrial enterprise in question has developed so well that its loans could again be transferred to the commercial bank as normal commercial engagements; in other cases, however, the liquidations have produced such unfavorable results that the Credit Bank has suffered heavy losses. The motive of the Credit Bank in supporting a commercial bank in trouble is thus an effort to save values which would otherwise become immediate and certain losses, by postponing the commercial enterprises' prospective liquidation until some later time.

THE SWEDISH RIKSBANK

The Swedish Riksbank as a Central Bank. As has been stated earlier, the organization and management of the Riksbank were completely changed in 1897 in connection with the monopolization of the issuing of bank notes. Before, the Riksbank had carried on banking business on a large scale with the general public direct, and its influence upon the money market was not predominant. Nevertheless, several of the larger banks regu-

lated their interest rates on the basis of the official discount rate, but most of them adopted a policy of their own in this respect. After 1897, however, the Riksbank became a true central bank, performing transactions typical of such an institution. The old commercial banking transactions, however, have not been wholly excluded. Thus the Riksbank has still the right to carry out almost the same kind of lending operations as the commercial banks, but it very seldom accepts deposits from the general public. Like other central banks, the Swedish Riksbank is now concentrating upon the principal problems at issue, viz., to provide the domestic market with an adequate amount of means of payment, to regulate money transactions with foreign countries, and to maintain the par value of the exchanges. The commercial banks, on the other hand, have taken over not only the deposit transactions but also to a large extent the lending operations, and therefore the Swedish Riksbank may now be referred to as "the bank of the banks."

Organization. The Special Bank Act of 1897 still regulates the activities of the Riksbank, although a number of amendments have altered the original provisions. A special ordinance of 1907 for the management of the Riksbank is also in force. The Riksbank is still a state institution, the activities of which are carried on for account of the Treasury. However, the bank is not administered by the executive Government but is placed under the direct supervision of the Parliament (Riksdag). The Riksbank is governed by 7 delegates (fullmäktige). One of these, the chairman, is nominated by the King for a period of three years, and the remaining six are elected by the Parliament also for a period of three years. Two of the last mentioned members resign each year, but they may be reëlected. The seven delegates select one of themselves to act as first president (deputrad) and two as second presidents, and these three assume principal charge over the work of the bank and its administration. A delegate of the Riksbank may not at the same time be a member of the board of another bank.

The operations and the management of the bank are examined by 12 auditors nominated yearly by the Parliament and governed by special instructions. The Riksbank must publish weekly reports regarding the note-circulation, more detailed monthly

statements and a yearbook containing full particulars about the business and the general administration of the bank during the past year.

THE NOTE ISSUE. One of the main objects of the Riksbank is to adjust the means of payment to the needs of the domestic money market. In accordance with the amendments of 1913 to the Bank Act, the Riksbank may issue bank notes up to double the amount of its gold holdings, and 125 million kronor in addition to that amount. The amount of notes issued beyond the amount of gold must be backed by —

1. Readily negotiable domestic and foreign Government securities;
2. Bonds issued by the General Mortgage Bank, the Town Mortgage Bank, or other Swedish bonds quoted on foreign exchanges;
3. Gold deposited abroad or in transit;
4. Domestic or foreign bills of exchange;
5. A credit balance at some bank or accepting house abroad maturing within 6 months;
6. Money advances against securities or bonds mentioned in 1 and 2 above.

A short time after the outbreak of the war in 1914 these limitations laid upon the note issue became too narrow, and in 1915 and 1918 amendments to the Act were passed giving King and Parliament together the right to permit the issue of an additional 250 million kronor (125 + 125) in the event of a menace of war or any other serious crisis.

The table at the top of the next page shows the notes in circulation, the gold reserve, and the per cent backing of the notes during various periods.

In order to regulate the note issue the Riksbank may buy and sell gold and silver, domestic bonds, foreign securities quoted on stock exchanges, and foreign bills of six months or less.

According to law the Riksbank should hold in its portfolio foreign bills to the same amount as the reserve fund. At present the reserve fund amounts to 12.5 million kronor or 25% of the capital stock of the bank.

TABLE IX

Metallic reserves, notes in circulation, and per cent backing

Average during the year	Gold 1,000.-kr.	Notes 1,000.-kr.	% Backing
1900	32,757	59,583	55.0
1905	65,476	157,081	41.7
1910	80,251	183,281	43.8
1913	102,404	209,924	48.8
1915	113,197	281,787	40.2
1920	268,925	710,710	37.8
1921	280,210	640,615	43.7
1922	274,074	554,848	49.4
1923	273,014	536,173	50.9
1924	254,260	510,169	49.8
1925	233,018	486,532	47.9

Discount and Lending Operations. In order to regulate the means of payment the Riksbank discounts bills payable after six months or less and grants loans for six months or less or for an unlimited period subject to at most three months' notice. The loans must be secured by bonds or debentures, shares, documentary securities, or liens on merchandise stored in public warehouses or in charge of a trustworthy third party. However, among these legal securities only a few first class bonds or debentures are in general accepted by the delegates as "eligible papers" and only a very limited amount is usually outstanding against securities other than bonds or debentures. Although the Riksbank has the right to discount bills and to grant loan accommodation to the commercial banks as well as to the general public, it is mostly the banks which apply to the Riksbank for accommodation.

Riksbank's Credit Methods. The Riksbank has no such regulations to follow in regard to the credit standing of the drawer of the bills, as those governing the Federal Reserve Banks. The Riksbank uses its own judgment in determining which bills are eligible for rediscount. In general, however, only commercial bills are eligible, although even accommodation bills are sometimes accepted for rediscount.

Further, the Riksbank may grant cash credits or overdrafts in

TABLE X

Average amount of domestic bills, loans, and cash credits

Year	(in thousands of kronor)			
	Bills	Loans	Cash credits	Bills in % of total loans
1901	58,826	19,490	6,663	69.2
1905	93,573	13,288	5,458	60.3
1910	118,419	19,907	5,439	78.8
1913	121,466	15,171	2,759	87.1
1915	93,103	29,115	2,135	74.9
1920	537,350	65,716	1,284	88.9
1921	450,885	28,565	1,994	93.7
1922	413,250	38,585	2,629	90.9
1923	294,210	49,756	1,943	85.1
1924	366,318	48,543	2,036	87.9
1925	313,487	42,873	2,045	87.5

current accounts for a period of not more than one year and to a total amount of 15 million kronor. The Act thus permits the Riksbank to carry on general banking transactions on very broad lines. However, the Riksbank takes but little advantage of this freedom and as will be seen from Table XI only 10–20% of the total acceptance portfolio consists of discounts accepted direct from the general public.

TABLE XI

Total amount of discounts and rediscounts

During year	Total (in thousands of kronor)	Rediscounts in % of total
1900	368,628	....
1905	621,530	81.4
1910	839,019	87.5
1913	938,721	92.9
1915	793,893	90.8
1920	3,544,279	93.9
1921	3,272,324	92.2
1922	3,071,104	90.7
1923	2,017,367	82.5
1924	2,499,628	85.5
1925	2,128,669	78.3

Installment Loan Fund. The Riksbank also administers a special installment loan fund which at present amounts to 35 million kronor. From this fund anyone found to be a good credit risk may receive loans, to be repaid semi-annually during 3, 5, or sometimes even 7½ years. No one, however, may receive accommodation for more than 6,000 kronor (about $1,600). The collateral security for these installment loans is mostly name guarantees although bonds or shares are sometimes accepted as collateral. It should be mentioned that the installment loan fund is specially administered and is not included among the other assets of the Riksbank.

In summing up the loan activities, we find that the Riksbank

1. Discounts and rediscounts bills;
2. Grants loan accommodation principally against a few first class bonds or debentures;
3. Grants cash credits and overdrafts in current accounts, also principally secured by bonds or debentures;
4. Grants installment loans from a special installment loan fund.

It ought to be mentioned that as a rule the Swedish commercial banks are indebted to the Riksbank either for rediscounts or for loans. From Table X we may see that in order to obtain additional funds the banks prefer to rediscount bills than obtain loans.

Clearing and Deposit Operations. In order to regulate and facilitate the money transactions of the country the Riksbank receives time or demand deposits without interest, and arranges local and inter-local clearings. The Riksbank may further receive interest-bearing checking deposits from such private customers (with the exception of banks) as have arranged for discounting facilities with the Riksbank. It should also be mentioned that in 1920 the Riksbank obtained the right to receive interest-bearing time deposits, but such accounts have not yet entered into the statement of the bank. The idea was that in virtue of this right the Riksbank should be enabled to compel the commercial banks to regulate their inward as well as outward interest rates according to the official rates.

The Riksbank places at the disposal of the commercial banks without charge rooms and necessary clerical staff for clearing purposes. The clearing institution was founded in Stockholm in the

year 1899 and in Gothenburg in 1918. All the commercial banks take part in the clearing either directly or through another bank. The clearing members who maintain checking accounts with the Riksbank must cover each day the clearing items to their debit. Each bank must therefore pledge with the Riksbank, as a guarantee, approved securities with an assessed value of 200,000 kronor. Instruments subject to clearing are checks drawn on any of the member banks or payable to any one of them, and "bank post bills."

FISCAL FUNCTIONS. Being a State Institution the Riksbank is obliged to receive State funds on deposit and to make disbursements therefrom without any charge, thus acting as the fiscal agent of the Government. Further, the National Debt Office (Riksgäldskontoret) is authorized to receive advances from the Riksbank without pledging any security up to an amount of 1.5 million kronor. From Table XII we see that only a small percentage of the total deposits with the Riksbank originate from the clearing banks, the discounting customers, and the general public, while the principal amount is State deposits.

Finally, the Riksbank receives securities in trust or for custody through its Trust Department.

Besides the Head Office in Stockholm, the Riksbank has 25 branch offices in certain of the larger towns throughout Sweden.

TABLE XII

Average checking accounts
(in thousands of kronor)

During year	Total	State funds in % of total
1900	33,920	....
1905	42,562	85.1
1910	43,196	90.4
1913	59,515	92.1
1915	79,199	89.9
1920	225,759	92.4
1921	192,753	94.6
1922	269,148	96.5
1923	208,789	95.6
1924	196,223	95.4
1925	202,651	96.4

Inflation During the World War. Although during the World War Sweden remained neutral, she had to meet much the same problems as the belligerent nations. At the outbreak of the war it was generally held in Sweden that it would be impossible or at least very difficult to keep out of the conflict and the country made all possible preparations. One of the first measures was to release the Riksbank from its obligations to redeem the notes with gold. Further, as in most other European countries, the discount rate was raised on two occasions, the one very shortly after the other, in all by 2 per cent. (Chart 2, p. 1071.) The banks closed on the first few days after the outbreak of the war and the Stock Exchange remained closed for about 3 months. A Royal Decree concerning a general moratorium was also issued, but it was possible to annul the Decree after a few months.

The following diagram represents the wholesale price index, as computed by the "Svensk Finanstidning" (*The Swedish Finance Journal*).

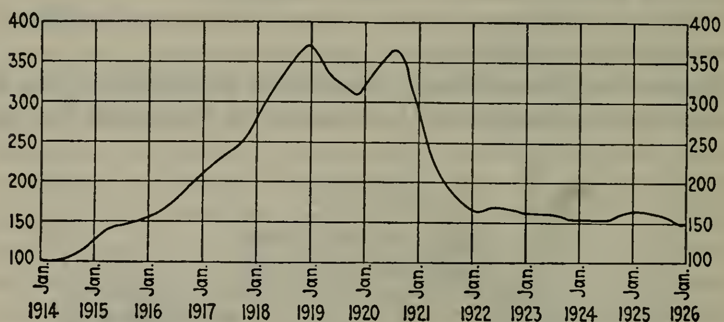

Chart I — Wholesale Price Level in Sweden, 1914–1925

This index is calculated on a basis of 48 different commodities, weighted in relation to the consumption during the period July 1, 1913 — June 30, 1914. The diagram follows the quarterly average figures. From the diagram it will be seen that the price index of Sweden was constantly advancing from the time of the outbreak of the war up to October 1918, when the first peak was reached — 370 as compared with the index number 100 in 1913–1914.

Cause of Price Change. The reason for this considerable advance in prices or fall in the value of the Swedish " krona " can be ascribed to several different factors.

On account of the war Sweden became to a large extent isolated from her old trading connections. While on the one hand the importation of goods was hampered, on the other hand the demand for exports was steadily growing, with the result that the scarcity of goods soon became very serious in Sweden. The belligerent nations offered any prices for commodities they required and consequently Swedish industries concentrated upon the production of goods for export. The high prices and the insistent demand created a very unsound boom, carrying with it a rise in prices as well as a scarcity of many important articles of consumption. In order as far as possible to remedy this evil, and also in order to economize the available supplies, the Government very soon took over practically the entire economic management of the country. However, the Government could succeed only with strong support and intimate coöperation on the part of the banks. At the beginning the Riksbank alone had to finance the enterprises of the Royal Commissions, which were charged with the procuring and distribution of commodities required for consumption in Sweden. An agreement was later concluded between the Riksbank and the commercial banks to the effect that the banks placed large amounts at the disposal of the Royal Commissions. However, it very soon proved that the banks could not supply the credits granted without the assistance of the Riksbank in the way of rediscounts. The Riksbank, however, had not sufficient reserves and therefore the only possible way out was further inflation.

Restrictions on Exports. Not only did the Swedish Government and the National Defences call for credit support, but the belligerent countries soon made it a condition of trade that exports to the neutral countries could only be permitted provided the neutral countries placed credits at the disposal of the belligerents by means of which imports from the neutrals could be financed. Consequently Sweden granted large credits to both of the belligerent parties.

At the beginning these credits were granted by individual banks, independently of one another, against open accounts or bank guarantee and in the exchanges of the foreign countries.

Later, however, the banks united and formed a special organization for the purpose of granting credits collectively to the foreign nations. By this means, the industries obtained more favorable conditions, as for instance the right to quote the prices either in foreign exchange at a fixed rate or in Swedish exchange. However, what Sweden needed was commodities in hand for credit accounts in foreign countries and gold and foreign securities were at present of less value. As it became almost impossible to obtain goods in payment for Swedish exports, the Government later on formed a special organization for this purpose. Partly through this agency and partly through political agreements, Sweden eventually succeeded in getting some of the necessary commodities in exchange for her exports.

Liberal Credits Needed. It should be pointed out that without this liberal granting of credits to foreign nations the large foreign orders to the Swedish export industries would hardly have been possible. The banks, however, had not themselves sufficient funds at disposal for the export credits, but had to turn to the Riksbank, as in the case of the financing of the domestic distribution of commodities through the Royal Commissions.

Besides these direct advances to foreign countries, the export of capital from Sweden to other countries took form as reimportation of Swedish securities, formerly placed abroad, and also the import of foreign securities. The significance of this export of capital may be seen from Table XIII below.

TABLE XIII

Securities purchased from foreign countries

(in thousands of kronor)

	Swedish		Foreign securities	Total
	Bonds and debentures	Shares		
July 1914 — end of 1918...	313,871	7,631	37,584	359,086
1919 — end of 1922........	284,145	4,734	13,778	302,657
1923 — end of 1925........	86,074	1,172	64,924	152,170
Total....................	684,090	13,537	116,286	813,913

As a further example of the difficulties encountered by Swedish importers may be mentioned the blockade system, which was gradually introduced by the Allied and Associated Powers. According to this system the Swedish importers had to guarantee that the goods were intended for consumption in Sweden and would not be sold to or be used as raw materials for goods intended to be sold to the Central Powers. Later on it was not even sufficient to give the personal guarantee of the importer, but he had to furnish a bank guarantee.

The Gold Policy. In August 1914 the Riksbank had been released from its obligation to redeem the notes in gold. This suspension of gold payments was extended by Royal Decree to February 4, 1916. During the time of non-redemption, however, the supply of gold in the vaults of the Riksbank considerably increased. From 108.5 million kronor at the end of 1914, it had grown to 124.6 million kronor by the end of 1915. As there seemed to be for the moment little danger of gold exports, the Riksbank voluntarily resumed gold redemption in January 1916.

As expected, gold was not withdrawn from the bank, but the supplies actually showed a continuous increase. By the end of January 1916, gold reserves had risen to 142 million kronor, and by the end of February to 161 million kronor.

Buying Gold for Riksbank. According to the provisions of the Bank Act, the Riksbank had to buy all gold offered at a fixed price of 2,480 kronor per kilogramme fine gold, less $\frac{1}{4}\%$ for cost of minting. As gold coins very seldom circulate in Sweden, the Riksbank had to pay for the gold either by issuing more notes, thereby increasing the note circulation beyond the actual need, or by the liquidation of some productive assets, which, however, entailed risks in view of the large sums involved. As a result of this situation, an amendment to the Bank Act was adopted on February 8, 1916, releasing the Riksbank from its obligation to purchase bullion for coinage or to exchange gold coins for bullion.

Thus the action was taken which has been so much discussed both in Sweden and abroad, and which led to the fact that the Swedish paper exchange rose above the value of gold.

By this amendment Sweden put a ban on gold imports, but this was contrary to the regulations of the Scandinavian Monetary

Union (founded in 1875), by which Denmark, Norway and Sweden had agreed to accept gold coins of the other contracting countries as legal tender. When the Danish and Norwegian exchanges were quoted at a discount in Stockholm (after the autumn of 1916), shipments of gold coins in large quantities took place from Denmark and Norway with a view to building up credit accounts in Swedish exchange. This highly embarrassing state of affairs continued until the fall of 1917. During this period of about a year and a half Sweden received 54 million kronor in gold from Denmark and Norway.

However, after the suspension of free coinage, the Riksbank went on receiving gold from other countries almost as much as before. By the end of 1915 Sweden had a gold reserve of 124.6 million kronor; at the end of 1916, 183.5 million kronor; at the end of 1917, 244.5 million kronor; and at the end of 1918, 285.6 million kronor. One of the main purposes of the suspension of gold purchases was to force the foreign countries to pay with consignments of raw materials and foodstuffs for their imports from Sweden, but in this Sweden was very unsuccessful.

Another purpose of the Riksbank policy was to prevent Swedish exchange from being depreciated to the same extent as gold. Neither in this case did the Riksbank achieve the success expected. The increase of notes in circulation continued after the exclusion of gold imports as rapidly as before. The Riksbank did not take advantage of this support to stop the inflation; hence this gold policy of the Swedish Riksbank failed.

The Foreign Exchanges. On the outbreak of the war confusion reigned on the exchange market in Sweden as in most other countries, but after a short time particularly the dollar, the £ sterling, and the French franc showed a rising tendency, while the rate of the mark fell. The dollar and the pound reached a high point in March 1915. After that even these exchanges began to fall and went below parity towards the end of the year. This low valuation of the foreign exchanges became still more marked later on, when Sweden, with a view to raising the krona above gold parity, as mentioned above, exempted the Riksbank from liability to purchase gold at a fixed price. In the following pages the dollar exchange will be primarily treated. The dollar was quoted in Stockholm below par from the end of 1915 to the

spring of 1919. The lowest quotation was in November 1917, when the dollar was paid at a rate of 2.34 as compared with the par rate of 3.73: i.e., the dollar was quoted at about 37% below par.

That the Swedish exchange was quoted below par in relation to the dollar, sterling, and franc during the first year of the war was due in large measure to the fact that the demand for Swedish commodities and thereby for Swedish exchange was not in proportion to the abundant supplies of Swedish kronor abroad. As a matter of fact, the belligerent nations centralized the supply of foreign exchange in order thereby to ensure that it was utilized in a manner most favorable to that particular country.

The principal reason why the Swedish exchange later reached so high a point is doubtless that the demand for Swedish commodities, and thereby for Swedish exchange, increased so enormously. Mention has just been made of how foreign countries stimulated Swedish exports by every available means, while the import to Sweden was hindered in every way possible. When, in view of this, Sweden adopted her gold policy of preventing gold from being shipped to the country, the consequence was that the Swedish exchange was overrated and the foreign exchange rates came to be quoted so low as they were.

Swedish-English-French Exchange. In order fully to explain the exchange relations between Sweden and the United States, we must consider also the relations between the Swedish and the English and French exchanges. In pre-war years Sweden had ordinarily imported less from Great Britain and France than she had exported to these countries. As already mentioned, however, there was during the war a growing excess of exports to imports from these countries.

The favorable balance of trade, together with the advantages of the neutral position as compared with that of the belligerent nations, caused the value of the pound and the franc to fall below par in Stockholm.

If we study the balance of trade between the United States and Sweden, we find that Sweden purchased more from the United States than she sold to that country, and although in this case the balance of trade was against Sweden, the dollar was, as previously shown, quoted below par after the end of 1915. This was

due in large measure to the fact that the sterling and franc exchanges were being "pegged" from London: i.e., the sterling in the United States was held by artificial means as high as about 2% below par and the franc about 9% below par. As a result bills drawn on London and on Paris were bought at a low rate of exchange in Stockholm, and transferred to New York, where such bills were higher in price on account of the "pegging" of sterling and francs. In March 1919, Great Britain stopped "pegging" her exchange, and immediately the dollar rose above par.

The gold policy of the Riksbank should then have shown its effectiveness, inasmuch as the object was to prevent Swedish exchange from following the depreciation of gold. Had the Riksbank succeeded in its policy, the dollar would not have gone above par at that time. But the circulation had increased to such an extent that Swedish exchange had depreciated below gold parity, i.e., prices in Sweden were relatively higher than in the United States. As a result the dollar, now representing the value of gold, rose over the parity of the Swedish exchange when the pegging of sterling stopped.

Post-War Inflation and Deflation. During the war general opinion was that the rise of prices was simply a result of the conflict. When the peace came in 1918, the public expected reductions in prices. Consequently consumers were reluctant buyers at the time when producers were most eager to sell. At the time of the Armistice most of the artificial restrictions of the international trade had already been abolished and Sweden found that she could import a number of long-needed articles. The reluctance of the purchasers in conjunction with the increase in the supply of commodities very largely explains why prices went down immediately after the Armistice. The index number, which had reached its maximum (370) in October 1918, began slowly to fall at the beginning of the year 1919. The bottom was reached in October, when the index number was 307, which means a reduction of 17% from the highest level.

But this decline in prices was of short duration. In 1919 a new rise in prices began which was as violent as the increase during the war. From October 1919 to June 1920, prices soared upwards, attaining approximately the 1918 level. The index number for Sweden was 366 in June 1920 as compared with 370 in

October 1918. Here was of course a new inflation, which could not be explained as a direct result of the war.

Many necessary public improvements in Sweden had been postponed during the war, but after the Armistice they all demanded attention. Now ensued a period of wasteful public expenditure, partly a natural result of the altogether too easily gained war profits, which were reaped by Sweden through selling at high prices to the belligerent nations.

Over-spending was by no means confined to the public, inasmuch as wealthy individuals now realized they were able for the first time in four years to purchase almost anything that money would buy. Demands for raw materials and foodstuffs increased enormously, and the result was a diminution of the large foreign balances which Sweden had built up during the war. The final outcome of this spending orgy was inflation, which was further increased by the taxpayers' demand for credits to meet their unusually high taxes.

When it became clear that Sweden was involved in the new period of world-wide inflation, which would bring about a further increase in the volume of currency and a fresh rise in prices, the Riksbank tried to check the inflation by increasing the discount rate — a remedy which had already been tried in many countries in a similar position.

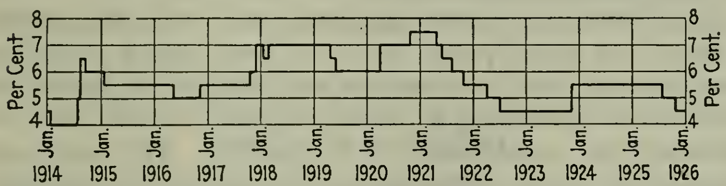

Chart II — The Discount Rate, the Swedish Riksbank, 1914–1925

Discount Rates and Inflation. In March 1920 the discount rate was raised to 7%. By this time the inflation had attained such momentum that prices were 14% higher than they had been about half a year previously. In September 1920 the discount rate was advanced to 7.5%, thus establishing a new record for the Riksbank. This exceedingly high discount rate led commercial banks in their turn to charge 8.5% to 9% for

loans, which was more than the borrowers could stand. Consequently the summer of 1920 witnessed a greatly diminished demand for credit, a contraction of the currency, and a fall in prices. Sweden was now involved in the world-wide crisis which had started in the United States and affected many other countries. In the meantime the Riksbank adopted a deliberate plan for bringing about deflation. By rigorously curtailing credit and by fixing a high discount rate the Riksbank cut down the credit demand and put a check on enterprises in general. The result was a realization of stocks and a diminished demand for labor. The discount rate, which had been 7½% since September 1920, was lowered to 7% in March 1921, and further reduced ½% every second or third month, reaching its lowest point, 4½%, in June 1922. From the autumn 1920 to the end of 1921, a period of less than 18 months, the price level dropped from 3½ times the pre-war level to a little more than 1½ times.

Although a violent fall in prices thus took place, it was not possible in Sweden, any more than in the case of other countries, for the continued lowering of the discount rate to raise the economic life of the country out of the slack-water in which it found itself. The reason of this was, of course, that the depression was not only due to the situation on the money market but mainly to the political and social conditions, which caused unrest in the economic life of Sweden.

The Restoration of the Gold Standard. When the postwar inflation had raised prices up to the level existing when the Armistice was signed, a committee was appointed to discuss the problems of preventing a further increase in prices and of bringing about a stabilization of the currency. This committee recommended in the first place that the policy of the Riksbank ought to be that of preventing a further increase in prices; second, of increasing the value of the currency gradually, thereby forcing down the price level; third, of restoring the gold standard as soon as possible. This program was later announced by the Riksbank in a new and enlarged form. The first two items on the program, viz., to stop the rise in prices and to increase the monetary value, had been carried through with such force that in comparison with it even the deflation in the United States can be called moderate. The recommendation to adopt the gold standard was not so easily

carried out. The Riksbank announced that as the value of the dollar and of gold had been so unstabilized for the last few years, it would not be wise for such a small nation as Sweden to be the first of all European countries to bind her exchange to the dollar by restoring the gold standard. However, the Riksbank pledged itself to do its utmost to keep the Swedish exchange stabilized with the dollar, without, however, adopting the gold standard.

Yet the restoration of the gold standard was always an urgent question, especially as the Swedish exchange and the dollar were later quoted at the old parity. As other conditions were also favorable in Sweden, Parliament voted to resume specie payments effective as from April 1, 1924. Accordingly from that date the Riksbank had to redeem its notes with gold and the embargo on the export of gold was removed. The importation of gold, however, was not allowed without authority and without license it can still only be carried out by the Riksbank. This last arrangement was due to the Labor Party, which was at that time as it is at present the strongest political party in Sweden. The reason was that there might be an influx of gold to Sweden especially from the United States, which might lead to another inflation, causing the purchasing power of wages to fall. With the right to import gold centralized in the Riksbank, Sweden would be able to free herself from a general depreciation of the value of gold. On the other hand, owing to the free exportation of gold, the Swedish prices would follow the world prices in a new process of deflation.

LIST OF THE CHIEF SOURCES OF BANKING AND MONETARY STATISTICS IN SWEDEN

Kungl. Bank- och Fondinspektionen, *Uppgifter om Bankerna* (Information about the Banks)

MONTHLY STATISTICS: Monthly balance sheet of the commercial banks, particulars of the Riksbank's and the commercial banks' interest rates on deposits and advances.

YEARLY STATISTICS: Changes during the year of: Number of banks and banking offices in operation, capital and surplus, deposits, bills and outstanding loans, bonds and share-holdings, amount due from and to foreign banks and bankers, amounts written off, net profits, interest rates, etc.

Statement of bank balances. Comparison of the balances for the last 5 years.

Information regarding Bill Brokers and the Stock Exchange.

Sveriges Riksbanks Arsbok (Annual Report of the Swedish Riksbank)
An account of the activities of the Riksbank during the past year with tables showing: Note circulation, foreign business, loans, miscellaneous branches of business, business done through its branches, the economic situation, discount rate and foreign exchange rates, etc.
As an appendix various tables regarding the commercial banks.

Svenska Bankföreningens Styrelses berättelse till årsmötet (Annual Report of the Swedish Bank Association)
Statistics of the commercial bank covering the last 10 years: Deposits, bills discounted, loans, cash in hand, interest rates applied to bills and loans against different kinds of collateral, foreign exchange rates, position vis-à-vis foreign banks and bankers, expenditure, amounts written off, Swedish bond issues, etc.

David Davidson, *Ekonomisk Tidskrift* (The Journal of Political Science) (About 10 numbers published yearly)
Statistics regarding railway traffic, weekly reports of the Riksbank and other Central Banks, Sweden's customs receipts, bank and private discount rates.
Combined monthly balance sheet of the principal commercial banks.

Kommerskollegium, *Ekonomisk Översikt* (Economic Review), quarterly
Statistics regarding money and banking, wholesale prices, cost of living, volume of trade and production, the labor market, State finances, etc.

Kungl. Statistiska Centralbyrån, *Statistisk Årsbok för Sverige* (Swedish Yearbook)
Among other statistics chapters dealing with: Joint stock companies, banking and money, trade and finances, etc.

CHAPTER XVI

THE BANKING SYSTEM OF SWITZERLAND

BY

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AN HISTORICAL SURVEY OF THE SWISS BANKING SYSTEM

INTRODUCTORY REMARKS. Switzerland lies in the heart of Europe between the most important of the continental nations. The country stretches across the Alps which divide Europe into a northern and southern part. The people of the South of Switzerland speak Italian, those of the North and East a dialect of the German and those of the West speak French. Due to this central location with its economic significance and due to the community of language with the resulting cultural associations, Switzerland is perhaps more closely bound with the destinies of Europe than any other small state. She is too small a political and economic unit, of course, to be able to work out her destiny in a completely independent fashion, and much of her welfare and independence rests on the prosperity and good-will of her neighbors. This has been true in the past and is true at present. Such international importance as regards the Continent manifests itself in all phases of economic life, including, of course, the money and banking phases.

INDUSTRIAL DEVELOPMENT. About 26% of the four million inhabitants of Switzerland are engaged in agriculture and since one-third of the area of the country is unproductive, agriculture has to be carried on in an intensive way. For this a well-developed credit organization is a necessity. At the time of the Reformation, religious fugitives brought the silk industry to Switzerland from France and Italy, and it is still carried on at the present time. Later, the manufacturing of cotton goods, embroideries and watches was introduced, first remaining domestic

industries, but with the growth of the credit organization, developing rapidly into important export industries. The industrial expansion of Switzerland dates back to about the middle of the last century and as in most other countries it was introduced and stimulated by railroad building. The unification of the 25 states under a Federal constitution in 1848 brought the necessary political stability, while the creation of banks which were in a position to supply the necessary capital or credit, provided the required financial basis. The industries developed as rapidly as did the banks, the development of the one going hand in hand with the development of the other. As economic life became more intense and diversified, a distinct banking structure gradually evolved.

Development of Various Groups of Banks. In 1650 there existed in Zurich a "Banco Exchange" which received deposits. This institution, however, was hardly anything else than an exchange brokerage office similar to the many exchange agencies existing at that time in all the important European cities. The first banks were private banks, which in most cases had their origin in merchandising or forwarding activities. Such private banks were established in Basel, Geneva, Berne and Zurich towards the end of the 18th century. In 1755 the canton or state of Zurich established a bank which received deposits and invested them abroad for the purpose of reducing the surplus of mortgage credits at home and preventing, thereby, a further decline of the interest rates paid on mortgage loans.

Formation of Savings Banks. Due to the growth in home industries the accumulation of capital proceeded rapidly. The small saver had practically no investment opportunities. His accumulations were too small for direct investments in mortgage loans. It was from this situation that the first savings banks developed. They were formed on a mutual basis, such as the "Diensten-Zinskasse" in Berne in 1786, with the underlying thought of pooling the savings and investing them in mortgage loans. Such savings institutions were organized in all the large Swiss cities at the beginning of the 19th century and there are now 21 savings banks in existence in Switzerland which have behind them a history of more than a hundred years.

The Origins of the Discount Banks. Throughout the second

and third decade of the last century home industries and trade developed rapidly. Raw materials had to be imported, and finished products exported. Gradually a great and real need developed for agencies that would supply the necessary short and long-term credits. The business men and industrialists now took their turn in establishing credit institutions of their own and founded the so-called discount banks. Banks of this type were established in 1837 in Zurich and St. Gall and later in Basel and in Geneva. They received deposits and issued bank notes and made loans and discounted paper, but were of local importance only.

Most of the large commercial banks in Switzerland were established in the fifties and sixties of the last century. They financed railroads, industry and trade and, while having at the start a local character, their activities soon spread not only over the whole country but also to foreign lands.

Cantonal Banks. The industrial expansion with its needs for short- as well as for long-term credits, shifted large amounts of capital from the land credit market, and as a result, the interest rates on mortgage loans began to rise. As the farm population began to suffer from the higher rates they finally requested the canton or state governments, directly or through the intermediation of the Assemblies, to intervene. Most of the states acted upon these requests and established issue banks of their own, the purpose of which was the granting of mortgage credits. The majority of these banks, usually called "cantonal banks," were formed between 1850 and 1890. With the exception of Geneva every canton has its own bank.

The Issuance of Notes. Up to the beginning of this century the issue of bank notes in Switzerland has never been limited to any specific type of banking institution. The first bank notes were issued in 1826 by a private bank in Berne. Other banks followed rapidly and it was not until 1881 that a Federal law regulating note issue was passed. This law was replaced in 1905 by an act which monopolized the note issue and established a central bank.

Growth in Banking Offices. The number of banks which existed in 1884 was estimated to be 307. In 1913, there were 307 independent banks which published statements, while the same

official sources reveal at the beginning of 1927, 334 banks.[1] These latter figures do not include the private banks and various mutual savings and coöperative banks. Professor J. Landmann of Basel counted in 1925, 780 banks and an aggregate of 1800 deposit agencies. There exists in Switzerland a deposit agency for about every 2200 inhabitants, while in England the corresponding figure would be about 4000 and in the United States about 5000.

Legislation Relating to Banking. The legislation of a democratic state is usually of the preventative and protective type, i. e., measures of a majority against a menacing minority or a reaction of the majority against the minority, as a result of losses inflicted by the latter. Legislative acts commonly draw the borderline between the individual and the general interest and where, as a natural outgrowth of existing conditions, be they mental or physical, the two interests are made to agree and kept in a balance, no legislation is necessary nor will it be brought into being. Quite often traditions, created and supported by a distinct mental attitude of a people, take the place of any formal legislation.

This is distinctly true for Europe. Most of the European countries, including England, France and Germany, have no general bank laws such as we find in the United States, and Switzerland is in a similar position.

No General Banking Law. The Swiss mentality has a liking for individuality and independence. It is opposed to excessive legislative regulation. Unless there exists an absolute contradiction between public and individual interest, laws will not be enacted. It is commonly assumed that any business enterprise, for its own advantage, will usually maintain a proper balance between the public interest and self-interest and since banks, the issue banks excepted, are considered as business institutions, no necessity was seen for subjecting them to special regulations.

There are no general banking laws in Switzerland with the exception of the Act of 1905, establishing a central bank, the various cantonal bank acts and the savings-bank laws in several states. The only regulations to which the banks are subject are those provided for corporations or coöperative societies or limited

[1] Statistical Publications of the Swiss National Bank (*Les Banques Suisses*) for the years 1913 and 1926. These statistics include only the banks which publish statements.

or unlimited private partnerships. The Swiss Commercial Code of Obligations in Articles 641 and 656 requires that corporations submit their yearly statements with earnings and auditor's reports at least eight days before the general meeting to the stockholders, and that such statements should be detailed enough to allow an insight into the true position of the corporation. About the same sort of regulations apply to the coöperative societies and banks.

At the beginning of 1927 the statistical publications of the Swiss National Bank listed 26 state institutions, 192 corporations and 91 coöperative institutions. The 26 state-owned institutions are subject to special regulations which vary from state to state. These laws usually circumscribe the activities of the banks, their administrative organization and the distribution of the profits. Some of the laws contain but a few general provisions while others are quite detailed.

Savings Bank Regulation. In Article 57 of the Supplementary Provisions to the new Civil Code of 1912 the states are authorized, until replaced by Federal legislation and subject to Federal approval, to legislate for the protection of savings deposits. As a result of this provision eleven states have established special regulations. These laws define the types of investment and create a special lien thereon. They contain protective provisions in regard to the chartering and supervision of the savings banks and usually compel such banks to publish their statements. They, however, impose no limitation on the activities of the banks. Most of these laws are strongly opposed by bankers, because it is maintained that they are too rigid in their investment requirements and do not cover the large savings deposits which are represented by the volume of outstanding debentures.

Auditing Associations. A great number of the banks escaped such state control by simply changing their corporation names (leaving out the word "savings" that meant inclusion under the law), without, of course, changing their business, while others, as a matter of protection, formed so-called "auditing associations" i.e., independent bodies which had for their purpose the making of regular examinations of the accounts of members, similar to the examinations conducted in the United States by the clearing-house associations. There are six states in which the savings

banks formed such examination associations. Several of the large commercial banks created similar organizations for the purpose of having their books examined by independent outside agencies which could also be used for an examination of the financial situation of customers. These " Treuhandgesellschaften " or " Sociétés fiduciaires," which combine the work of a public accountant with the trust work of an American trust company, are also well known in Germany. As far as the outside public was concerned, there was also the possibility of using these agencies as a shield against possible demands for regular government examinations.[2]

Bank Failures. Bank failures in Switzerland up to a few years before the war had never been numerous, though in the case of a number of smaller local institutions, a comparatively large number of failures occurred between 1910 and 1913. Causes of these included speculation, inexperienced management and lack of sufficient supervision. These failures aroused public opinion and in June 1913, a motion was made in Parliament to revise the Corporation Act for the purpose of establishing separate banking regulations. The Federal government entrusted at once to several experts the task of writing a draft for a possible bank law but as a result of war developments, nothing farther was done. The drafts when completed, were and still are kept secret and unless new failures should occur, it is not likely that any bank legislation will be taken into consideration within the near future, exception being made of the possible regulation of the issue of mortgage bonds, which will be discussed later.

MONETARY AND CREDIT SYSTEM

Currency Problems. Switzerland had no uniform currency system prior to May 7, 1850, when a law was made adopting the silver franc, 9/10 fine, as the monetary unit. In 1852 the French, Belgian and Sardinian francs were made legal tender, but even before that time and for many years after, Switzerland was supplied with most of her currency from France. The active trade relations which the country had with France and the importance of Paris as a financial center, willing to finance Swiss railroads and industry, were the bases for this dependence.

[2] The regulation of the note issue will be discussed separately.

The Latin Monetary Union. The increased gold production of the fifties of the last century, however, drove silver out of circulation (through the operation of Gresham's law) and, since Switzerland did no minting of her own, the French gold coins were made legal tender in 1860. To prevent a further decrease in silver circulation, at the proposal of France, Switzerland joined France, Belgium and Italy in forming the Latin Monetary Union on December 23, 1865.

The history of the currency unit in Switzerland has in the past been closely bound up with the history of this Union, which is discussed elsewhere in this book. All that will interest us here is a sketch of the Swiss attitude towards the Union. The almost complete dependence of Switzerland on France in all currency and in many financial matters was the reason she joined the Union. As already stated, she did practically no minting of her own at that time and received most of her coin supply from France, Belgium and Italy. During the Franco-German War, for instance, when the French supply stopped, the coins in Switzerland were so scarce that for several months the pound sterling and the United States dollar were made legal tender.

This dependence, however, had certain disadvantages. As long as the market ratio between gold and silver remained at 1 to 15½ the circulation of foreign silver coins was perfectly agreeable to Switzerland. A fall in the price of silver, however, changed the situation. When Germany and other countries adopted the gold standard after the Franco-German War, the price of silver began to decline, and as Switzerland had no interest in possessing large quantities of intrinsically depreciated coins of foreign origin, she proposed in 1874 that the amount of silver coins to be issued by each member be limited. This was done, and in 1878 it was decided to suspend any further free coinage of five-franc silver pieces. In 1885, Switzerland gave notice of withdrawal from the Union, but renewed the membership again when the agreement was reached that in case of withdrawal from the Union, the countries had to reimburse each other up to a certain limit for the difference between the nominal and the silver value of the five-franc silver pieces in their possession, which had not been minted by themselves.

Inflow of Foreign Silver Coins After the War. During and especially after the World War when the currencies of all the other Union members began to decline, their five-franc silver pieces began to flow to Switzerland where they still could legally circulate. This movement stopped for a while in 1919 when the price of silver increased and the $1{:}15\frac{1}{2}$ ratio was reëstablished. But with the renewed fall in the price of silver which followed, the inflow increased rapidly. The country gradually became flooded with five-franc pieces and since the agreement of 1885 had limited the amount of five-franc pieces which each member was to take back from the others, the Federal Government prohibited on October 4, 1920, a further importation of such foreign silver pieces and decided on December 28, 1920, that all pieces in circulation had to be withdrawn within three months. The conference of the Union members of December 9, 1921, approved of this action and arrangements were made for the gradual exchange of, and reimbursement for, the silver coins which were within the limits fixed in 1885. However, no provisions were made for the exchange of such silver pieces (approximately 60,000,000 francs) as exceeded the limits, and Switzerland consequently had to absorb the loss resulting from the difference between the nominal and the intrinsic value of the coins. The coin exchange between the various countries began to operate in 1927 and continues until 1932.

In 1920 a possible withdrawal of Switzerland from the Union was discussed but it then was decided that, while from a financial point of view a withdrawal would be the best solution, political and social considerations would not justify such action. However, in November 1925, Belgium served notice of withdrawal from the Union. The Swiss Government at once examined the situation resulting from this action and decided on December 3, 1926, that such a withdrawal was tantamount to a liquidation of the Latin Monetary Union and informed the other Governments that it would not consider the Union as any longer existing. Accordingly, since April 1, 1927, the gold coins of the previous Union members are no longer legal tender in Switzerland, and it may be stated that on that date the Swiss circulation became completely nationalized. On the whole it may be added that Switzerland would probably have done much better if she had with-

drawn from the Union some 20 or 30 years ago, adopting at the same time a gold standard. While there is no doubt that the uniform currency facilitated trade, it should be pointed out that the gold standard, had it been accepted in 1885, would have meant independence and avoidance of losses which had to be borne in recent years when the foreign silver coin holdings were melted. Officially, Switzerland was at the beginning of 1928 still under the bi-metallic régime, but it is to be expected that legislation putting her currency system formally on a gold standard or a gold exchange standard basis will be enacted in the near future.

SUMMARY. A short review of the currency *media* shows us that up to 1860 nearly all consisted of silver coins, and that thereafter gold coins took the place of silver. Since 1873 silver has again been circulating to some extent, but amounted in 1926 to only about 2% of total currency and note circulation. The bank notes constituted in 1926 about three-fourths of the media of circulation. The latest estimates show a per capita currency and note circulation of about $63.00 as against $42.00 in the United States. Compared with 1913 the per capita note circulation in Switzerland had in 1926 increased by about 83%, against a decrease of 12% in the United States and an increase of 60% in Holland, 43% in France and 39% in Sweden.[3] The causes of this increase will be discussed under a later heading.

CREDIT INSTRUMENTS

The evidence of credit and the exact form which it takes will always vary in accordance with the circumstances which gave rise to it. These circumstances are dependent on existing economic conditions subject to laws, customs and habits, which means that in each country the form of the credit instruments and their use will vary somewhat as a result of differences in local conditions.

Switzerland is rich in contrasts which are of a political, economic, religious and general cultural order and are remnants of the European past. Nearly each state or " canton " shows a certain individuality which finds its outer expression in dif-

[3] Statistical Publications of the Swiss National Bank: *Der Zahlungsmittelumlauf der Schweiz im Jahre 1926 im Vergleich zur Vorkriegzeit* p. 44.

ferences of law and custom. Differences, therefore, can also be traced in the form and use of credit instruments, although they are rapidly disappearing, as state laws have gradually been replaced by Federal laws and a uniform basis created throughout the whole country. The great and increasing amount of foreign business naturally has led to the adoption of international credit instruments by all the large commercial banks. Many of the small local institutions, however, depend for their instruments still strongly on local customs and habits.

The most common *commercial* credit instruments are the open book and giro account, bills of exchange, promissory notes, checks, and the postal checks and giro accounts, while *investment* credit appears in the form of bonds and stock certificates.

A Swiss bank as a rule, when granting credit, follows the American method of crediting the full amount of the loan to a loan account, or adopts the continental and British practice of fixing a limit up to which the customer may overdraw his regular current account.

Giro Accounts. The giro accounts represent non-interest bearing balances kept with the central institution for the settlement of indebtedness through transfer from one account to the other without the use of checks or currency. The aggregate amount of such transfers was, in 1926, more than five times as large as the aggregate amount of clearings made by all clearing houses of the country. This may partly be explained by the fact that the use of checks is considerably less extensive in Switzerland and in all countries of continental Europe than in England and the United States. Only business houses or wealthy individuals carry deposit or check accounts while a great part of the population effects its payments with bank notes.

The use of bills of exchange in Switzerland is much more frequent than in the United States, while on the other hand promissory notes are not so popular. The supply of acceptances depends, of course, on general business conditions, i. e., on the volume of production and trade.

Postal Check System. A great and increasing number of the smaller payments in Switzerland are effected through the postal check and giro system. The whole country is divided into districts, similar to the Federal Reserve Districts. Each District has

a central office which keeps the accounts of the members. When making payments an individual ascertains whether the beneficiary has a postal giro account and if so, orders the district office to make the necessary transfer. If the beneficiary has no account, he will order the office to make payment in currency through the post office of the beneficiary. The whole system is very practical and convenient and its use is rapidly increasing. It might seem to outsiders that such a system would be in competition with banks and deprive them of certain opportunities for profit, which is probably true but, on the other hand, it relieves them of a great many small payments with the ensuing detail work and since the system grants no credit, but invests its holdings in government securities, it is not strongly opposed by banking circles.

Investment Credit Instruments. The usual *investment* or long-term credit instruments in Switzerland are bonds and stocks. The bonds are in character and form similar to the corresponding instrument used in the United States, except that the majority of them are notes and debentures and only a smaller part are mortgage bonds. The stock certificates are in character and significance the same. They, however, differ somewhat in form, for most of the certificates are in bearer form with dividend warrants attached, similar to the coupon sheets on the bonds. Upon declaration of dividends these warrants are presented for payment like coupons. No such intermediaries as a registrar or transfer agent are therefore necessary. The certificates are usually issued directly by the company or its banker. The liability of the holder of bank stocks is limited to their principal amount.

The "Cash Obligation." One of the most typical Swiss investment instruments is the so-called "cash obligation" a debenture bond which is issued by nearly all the banks for short terms, such as from one to five years at a fixed rate of interest.[4] It is more or less the equivalent of the "time deposit account" in the United States, issued, however, in the form of a bond. It fills to some extent the gap between short- and long-term credit.

The provisions of the Swiss Code which refer to negotiable

[4] Debenture bonds of a similar type have been sold in New York by two of the large German banks in the autumn of 1927.

instruments are fundamentally the same as those of all other continental countries. As far as negotiability, indorsement, protest and enforcement are concerned these laws are more or less in agreement with British and American practice. They vary of course as to details. There is, however, an important difference in regard to recourse. If in continental Europe a check or a draft has been paid in good faith, no recourse can be had, even if some of the signatures are forged, while in the United States an instrument can only be paid to the person who has a good title to it, which means, that in case of a forgery, recourse may be had even after payment. This is a very important difference in the regulation of international payments and it has been the cause of much misunderstanding in recent years between European and American banks. The time is probably not so far distant when, in this age of economic interdependence, the negotiable instrument laws of the most important commercial nations will be revised on a uniform basis. The recent efforts of the League of Nations in this direction merit full attention and support.

THE BANKING SYSTEM

In Switzerland, the various types of credit such as commercial credit and long-term industrial as well as land credits are supplied by more or less distinct groups of banks which coöperate with a central bank. The groups might be classified into short-term credit banks and into investment, i.e., long-term credit institutions. However, a much better insight is obtained if they are discussed with a view to the particular type of credit which they grant and with a view to their historical development.

The largest group of banks is the commercial banks. They represent about one third of the total bank resources of the country. The cantonal banks hold another third of such resources, and the last third belongs to the remaining banks. This shows clearly that no group dominates absolutely, and that there exist on the whole healthy proportions in the credit distributing structure.

Unspecialized Character of Banking. Banking in Switzerland is not specialized. While it is possible to distinguish be-

tween certain types of banks, it should be made clear that few banks are specialized and that nearly all, probably due to the absence of legal restrictions and as a result of competition, grant short- as well as long-term credit. The degree to which this is done differs, of course, among the various institutions.

Concentration Movement. Up to the beginning of this century few banks, with the exception of the cantonal banks, had any branches. But then, as competition grew stronger and business and trade expanded rapidly, concentration took place and the large commercial banks began to establish branches in all the important cities of the country. The great number of failures of independent local banks before the war and the war events hastened the concentration movement and the development of branch banking.

The Commercial Banks. The first rapid development of industry and commerce in Switzerland took place during the second quarter of the last century. No commercial banks were in existence at that time and to satisfy the needs such banks were created in various cities. They limited themselves mostly to the discounting of bills and granting of credits and some of them also issued bank notes.

Around the middle of the century great efforts were made to construct railroads. At the same time, partly due to the increasing popularity of the corporate type of enterprise, large industrial concerns were established. Both of these types of corporate enterprise had to be financed. The existing commercial banks were not equipped for such financial transactions and the private banks were too small for the handling of big business. Other banks did not exist. They, therefore, had to be created, since the country did not want to depend solely on foreign financial centers. Thus a new type of bank arose, a combination between commercial and industrial banks. The first bank of this type was the Crédit Suisse which was founded in Zurich in 1856 and developed rapidly into one of the strongest credit institutions of the country. Other banks followed, but as a true reflection of the great regional variety in economic activities they were not all established in one single money market but developed in the various regional centers. There exist today eight large banks

of this type. They will be called in this discussion the "big banks." Four of them have their head office in Zurich, two in Basel, one in Geneva and one in Berne.[5] Most of them, as they appear today, are the product of a great number of mergers and amalgamations with other banks. The concentration movement began in Switzerland around the beginning of the century and continued up to and throughout the war period. With the exception of one, all of these eight banks have branch offices and agencies throughout the country, one of them having as many as 54 branches and agencies in 1926. Most of the oldest commercial banks and a great many of the private banks were absorbed by this concentration process which, as in the case of all the other European countries, was the outgrowth of changed economic conditions and of an intensive competitive struggle. The statistics of the Swiss National Bank list, at the beginning of 1926, 85 banks which are of the type that may be included in this grouping of commercial banks. Seventy-seven of them are corporations and eight are coöperative banks. Seven of the eight "big banks" are corporations and one of them is a coöperative enterprise with a membership of 77,570 persons at the beginning of 1926. The eight big banks show resources that are more than three times as large as those of the 77 local commercial banks and represent about one-third of the aggregate banking resources of the country. These eight banks are probably the most important group of banks in Switzerland. They have not an exclusive position such as the "Big Five" in London or the "D" Banks in Germany, but they also represent the interests of large commerce and industry and handle most of the foreign business.

Characteristics of the Large Swiss Banks. For textbook purposes it is well to compare and classify banks according to certain characteristics and policies in their activities. Thus we speak of deposit banks such as the big English banks and in a

[5] The eight banks are: Schweizerische Kreditanstalt, Zurich, (Crédit Suisse); Schweizerischer Bankverein, Basel, (Swiss Bank Corporation, Société de Banque Suisse); Schweizerische Volksbank, Berne, (Banque Populaire Suisse); Schweizerische Bankgesellschaft, Winterthur (Zurich) (Union Bank of Switzerland, Union de Banques Suisses); Basler Handelsbank, Basel (Banque Commerciale de Bâle); Eidgenössische Bank A.G., Zurich, (Banque Fédérale S.A.); Comptoir d'Escompte de Genève. Geneva: Aktiengesellschaft Leu & Co., Zurich. —

lesser degree the French banks, or of industrial banks such as the Austrian and the German " D " banks. The large Swiss banks belong to neither of these types. They might be classified perhaps, somewhere between the French Crédit Lyonnais type of bank and the German " D " banks. They are deposit banks that carry on a large investment business and do not hesitate to finance industry without, however, taking any direct control. The Boards of Directors of these banks resemble in composition and competence the average Board of Directors of a big New York bank. The directors are mostly merchants and industrialists representing a great variety of economic interests and, while the banks have their representative, acting as a financial adviser, on the Boards of most of the large industrial companies, it could not be said that they usually have any controlling influence. They grant credits to the companies, and in some cases they may gain thereby a certain influence over their customers, but such instances are rather exceptional and of short duration. But the banks, in their own interest, are of course coöperating with their clients wherever they can. Thus they created trust companies which had to develop markets and, in some instances, formed the channels through which a certain control over industry could be exercised. These trust companies will be discussed separately.

The large Swiss commercial bank receives deposits, issues short-term notes and debentures, accepts drafts, makes short- and long-term loans and invests in securities. It carries on all phases of investment banking such as underwriting activities and also renders its customers trust services. The balance sheet items of the " big banks," in percentages of the total resources, showed in 1913 and 1926 respectively, the following proportions: [6]

Balance Sheet

	1913	1926
Assets	%	%
Cash reserve and giro	2.29	3.71
Bank correspondents	4.27	16.76
Portfolio	16.37	20.11
Call loans	5.20	.91
Total Short term assets	28.13	41.49

[6] Statistical publications of the Swiss National Bank for 1913 and 1925.

	1913	1926
Brought forward	28.13	41.49
Loans	48.75	46.71
Time loans	5.80	1.01
Mortgage loans	6.76	4.79 [7]
Investments and participations	8.02	4.21
Real estate	1.54	1.70
Various	1.00	.09
	100.00	100.00

Liabilities	1913 %	1926 %
Capital and surplus	19.14	14.24
Deposits, savings and debentures	64.06	75.79
Acceptances and drafts	14.49	8.99
Various	2.31	.98
	100.00	100.00

	1913 %	1926 %
Deposits about	53.20	71.77
Debentures	42.47	20.66
Savings	4.33	7.57 [7]
	100.00	100.00

The total resources of the eight big banks amounted at the beginning of 1927 to 5,614,786,000 francs or roughly to $1,083,-000,000. The largest bank, Schweizerische Kreditanstalt, Zurich, had early in 1928 deposits (including debentures) totaling about $152,000,000. Its balance sheet, as a typical Swiss bank statement, showed at the beginning of 1928 the following picture:

Balance Sheet as of December 31, 1926

Assets	
Cash	fr. 41,050,629
Portfolio	192,612,860
Banks and bankers	216,329,389
Call loans and short term advances	8,692,926
Security holdings and permanent investments	17,849,381
Shares of the Banque de Zurich	4,992,500
Coupons	792,593
Mortgage loans	1,468,020
Carried forward	fr. 483,788,298

[7] The "Schweizerische Volksbank" is the only one of the big banks which accepts straight savings and makes mortgage loans of importance; however all the other banks accept deposits on pass-books somewhat on a different basis but of a similar character.

Brought forward .... fr.	483,788,298
Secured loans	387,973,817
Unsecured loans	100,074,069
Acceptance credits	143,313,256
Participation in syndicates	23,335,083
Real estate	10,500,000
Furniture	1
Total fr.	1,148,984,524
Guarantees .... fr.	19,727,084

Liabilities

Capital stock .... fr.	130,000,000
Surplus	15,000,000
Special reserves	25,000,000
Checking accounts	33,756,035
Banks	162,636,510
Sight deposits	253,694,303
Acceptances	136,516,894
Sight drawings, etc.	6,073,751
Short-term deposits	98,202,098
Time deposits (exceeding 6 months)	41,637,879
Pass-book deposits (equivalent to savings deposits)	91,160,843
Debentures	140,790,500
Balance profit-and-loss account	14,515,710
Total fr.	1,148,984,523
Guarantees .... fr.	19,727,084

In glancing over the above percentages at least one of the items must strike the reader at once, i.e., debentures. This item is to be found on the balance sheet of practically every Swiss bank and is one of the outstanding characteristics of Swiss banking. On the balance sheet of an American bank, the corresponding item would read "time deposits." These debentures are issued for a period of from one to five years at a fixed rate of interest which is somewhat higher than the deposit rate. They are not quoted anywhere and therefore not subject to frequent fluctuations. They are very popular and are naturally much appreciated by the commercial banks because of their fixed semi-long-term maturities. The average net dividend earned by the big banks in 1926 on the invested capital amounted to 7.34%.

Relation of Large Swiss Banks to Security Flotations. All of the banks are well equipped for and experienced in investment banking. As far back as 1897 three banks formed a "Car-

tel of the Swiss banks" having the character of a syndicate for the flotation of all large loans. Today this syndicate includes all the big banks and also two other institutions. It floats, in co-operation with the syndicate of the cantonal banks, all the government loans. Smaller loans are, of course, floated directly by the individual houses. All of the banks have their representatives at the stock exchanges and buy and sell securities for their own account as well as for account of their customers. In this connection they maintain well equipped safe-custody services and perform other trust services that arise from this business, such as estate management and testamentary execution. Trust work, however, is not so actively pushed as by the American banks but has still more or less the character of a "side line."

Economic Rôle of the Eight Large Banks. The rôle which the eight big commercial banks are playing in the economic life of Switzerland is an extremely important one. They are the hub around which most of the large business in Switzerland and especially the international business revolves. The banks have been financing foreign business extensively and spread their influence also to foreign countries. The largest Italian bank was founded by German, Austrian, and Swiss banks; Swiss capital went also into Belgian, Serbian, and French banks. The banks established close connections with all the leading foreign banks. Only one of them established a branch office abroad (Swiss Bank Corporation in London), while only a few foreign banks have established branches in Switzerland. As a result of these activities the prestige of the banks increased considerably both at home and abroad and they succeeded in creating and maintaining an important position in international banking and finance which became the basis of their rapid growth during and after the World War.

The commercial banks were of great service to the country during the War. At the request of the Government they granted credits to the belligerents to permit the importation of raw materials and foodstuffs. After the war these banks, like the large banks in all the neutral countries, became the intermediaries through which the broken threads of international banking and finance were reconnected. The Swiss banks, owing to their geo-

graphical location and the sound state of the Swiss currency, became largely intermediaries for Central Europe. This they have been for nearly a decade and will probably remain, to a smaller extent, of course, when international relations become more normal. In recent years they have been extremely active in granting foreign loans to such countries as France, Belgium, Germany and others, many of these loans being made in conjunction with large New York and Amsterdam issues. These international activities increased their power and prestige and in spite of some losses suffered by most of these banks, they emerged from the war and after-war period much stronger than before.

THE CANTONAL BANKS. The cantonal banks, numbering 24 in all, are institutions established by the various state governments, mostly during the third quarter of the last century and largely for the purpose of facilitating land credits. Two of these 24 banks are corporations and the others are state-owned institutions subject to separate state laws. But these laws are no more uniform than the various state banking acts in the United States; some of them are detailed and precise, others are short and vague, but all of them stipulate to a greater or less extent that these banks shall facilitate land credits and finance the small business people. The smallest cantonal bank [8] has a capital of 500,000 francs (about $100,000) and the largest [9] one of 70,000,000 francs (about $14,000,000). Out of 22 banks, 15 do not pay any taxes to the states. The supervision of the banks lies usually with the state assemblies. The profits, after deduction of an interest charge on the invested capital, go in part to a reserve account and in part to the state treasury or to charitable institutions.

TYPE OF ACTIVITIES. Allusion has already been made to the great variety of interests existing in the different states of Switzerland, a variation that finds its reflection in the activities of the various state banks. There is little uniformity in the activities of these banks. Some, mainly in the agricultural states, are similar in all respects to mortgage banks with practically no other activities than the granting of land credits. The cantonal banks in the industrial and commercial states, however, have a much wider

[8] Appenzell-Innerrhodische Kantonalbank.
[9] Kantonalbank Zurich.

range of activities. They are permitted, as one of the laws states: [10]

> "To make mortgage loans within the state territory; to buy and sell mortgage bonds; to act as receiver; to make loans to municipalities and coöperative organizations; to underwrite alone or in coöperation with others Federal, state and municipal issues as well as first-class corporate issues; to make loans against chattel mortgage; to discount, collect, buy and sell bills of exchange, checks and coupons and to transact foreign exchange business; to buy and sell securities for account of third parties; to buy and sell gilt-edged securities for own investment purposes; to grant secured loans in current accounts; to transact giro and collection business; to safe-keep securities and other valuable objects; to handle and liquidate estates and execute testaments; to lease safe-deposit boxes; to accept and hold savings; to organize a pawnbroker's shop and provided showrooms for artisans."

This includes nearly every phase of banking with the exception of speculative investment and note issue. Up to 1907, when the note issue was centralized, nearly all the cantonal banks issued bank notes, part of which were covered by commercial paper. Through their discount activities the banks came into close contact with commerce and industry which explains the great variety of their services.

The following table, which shows the relative importance of each item on the combined balance-sheets of the 24 cantonal banks, gives a picture of the activities of these banks and illustrates also some of the changes which have taken place since 1913: [11]

Assets	1913 %	1926 %
Cash reserve and giro	.80	.95
Bank correspondents	2.85	4.29
Portfolio	7.71	5.75
Call loans	2.03	.83
Total short-term. assets	13.39	11.82

[10] Act of Kantonalbank Zurich, revised as of March 8, 1926.
[11] Statistical publications of the Swiss National Bank for 1913 & 1925.

Brought forward	13.39	11.82
Loans	15.74	17.20
Time loans	8.16	6.71
Mortgage loans	45.04	49.90
Loans to municipalities	3.89	2.90
Investments	4.82	8.03
Real estate	.53	.89
Various	8.43	2.55
	86.61	88.18
	100.00	100.00

Liabilities	1913 %	1926 %
Capital and surplus	11.78	11.57
Deposits, savings and debentures	79.48	85.42
Acceptances and drawings	.69	.86
Other liabilities	8.05	2.15
	100.00	100.00

	1913 %	1926 %
Deposits about	18.45	18.29
Debentures	57.04	46.92
Savings	24.51	34.79
	100.00	100.00

At the beginning of 1927 the total resources of these banks amounted to 4,902,840 francs ($946,000). These banks work with a comparatively low capital which can only be justified by the state guarantee which they enjoy. Nearly half of their resources result from the sale of their own debentures and more than one fourth are received as savings deposits. These debentures have comparatively short maturities, from 3 to 5 years, and efforts are now made to introduce into the Swiss market long-term mortgage bonds. As shown by the above table, the cantonal banks still invest about half of their resources in mortgage loans. Their aggregate mortgage loans are nearly half as large as those of all the other banks combined. The experiment with these state-owned institutions has been a very successful one. The banks were able to issue their debentures often at lower interest rates than the private institutions, thanks to their state guarantee and tax exemption, and were therefore in a position to charge lower rates on the loans granted. They gradually succeeded in attracting a great part of this business and became a

powerful and stabilizing influence in the agricultural and urban long-term credit market.

The loans made by the cantonal banks to municipalities show quite respectable proportions. They are only granted after a careful survey of the wealth and the tax situation of a certain community. They were especially high in the years immediately following the war. On account of the larger profit possibilities, the commercial activities of some of these banks increased greatly during the war. Such banks as the cantonal banks of Zurich and Berne have very large portfolios and a comparatively large amount of commercial loans outstanding. Their customers are mostly people that do a large business within the state borders, a somewhat different class of people than those with whom the big commercial banks deal. Nevertheless some competition exists between these two groups of banks. The international business done by the cantonal banks is not very large. Most of them have a number of branch offices and agencies all over the whole state territory, which facilitates, of course, the transaction of commercial banking, but since these banks as a rule are not allowed to grant unsecured loans, their expansion towards commercial banking will always be subject to a certain restraint. The net earnings of the cantonal banks in recent years have been comparatively larger than those of any other group of banks which, however, is largely due to the fact that they are strongly tax-exempt.[12]

The important position which the cantonal banks have in the banking structure arises from their exercise of a sound control over the long-term land credit market. Nevertheless, it may perhaps be asked whether these banks were really a success, and why the other banks tolerate the competition of such state institutions. The cantonal banks are very popular and there is no doubt that, thanks to their state ownership, they were able to take a certain leadership, and to regulate the credit market somewhat in the interest of the general public. The other banks have unquestionably felt the competition and have justly tried to oppose an unfair (tax-exempt!) competition by these state institutions.

[12] In 1924 the average net dividend on invested capital and surplus amounted to 5.63%; in 1925 to 5.76%. Statistical publications of the Swiss National Bank for the years 1924 and 1925.

But they did not succeed since the actual success of these banks in granting land credits could not be denied.

In 1907 the 24 cantonal banks formed an "Association of the Cantonal Banks" for the purpose of adopting uniform agreements in rate regulations and especially for the underwriting of Federal and state issues. Since 1911, in coöperation with the "Bank Cartel" of the big commercial banks this association is successfully handling all the large Federal and State emissions in Switzerland.

Trust Companies. The European trust bank differs greatly from the American trust company. The latter is an institution that performs all types of fiduciary activities and grants full banking service, while the former is rather an investment trust which offers also certain banking facilities. The fiduciary functions are carried on in Europe partly by the commercial banks and partly by distinct fiduciary organizations which were sketched previously.

The Swiss trust bank issues its own stock and long-term debenture bonds on an average basis (in 1926) of 55% stock and 45% bonds, holds some deposits, and invests these funds to about 55% in securities and the remainder in loans. The investments in securities, which form the main object of these institutions, are made either with a view of deriving a profit from the margin between the interest paid on the debentures and received on diversified holdings, or they are made for the purpose of acquiring a controlling interest in a concern. The first is the typical investment trust, as strongly developed in England and Scotland and in recent years in the United States, and the second type is a holding company or trust similar to organizations found in Belgium. Both types of organizations have been known in Switzerland for many years. In fact, it may be said that the first investment trust in Switzerland existed years before the establishment of similar institutions in France and England.

The first trust bank was formed in 1849 in Geneva by a few private bankers and was of the investment trust type. At the beginning of 1927 the bank statistics of the Swiss National Bank listed 30 trust banks with total resources of 949,000,000 francs ($183,000,000). The capital stock of these institutions ranges from 500,000 francs (about $100,000) to 75,000,000 francs (about

$15,000,000). Most of them were established around the beginning of this century, largely on the initiative and under the control of the big commercial banks. They formed, to some extent at least, a channel through which the banks could exercise an influence on industry without becoming too closely identified with it. In a good many cases these trust banks had to create markets for some of the large industries such as the electrical and machine industries. They financed, for instance, public utility concerns in many European countries which in turn had to obtain their supplies from the Swiss industries. Many of the trust banks, however, were established with foreign assistance.

Best Known Trust Banks. Among the most important of the trust banks is the Union Financière de Genève, which is an underwriting concern and holding company of the private bankers of Geneva. This institution is practically the only trust bank that underwrites loans. It controls a number of investment trusts with interests all over Europe, the Balkans, the North American continent and Japan. In Zurich, we find a number of institutions that have close connections with the Crédit Suisse, such as the Bank for Oriental Railroads, which was established with German, French and English capital, and the Bank for Electrical Enterprises. The A. G. Leu established the Swiss Bank for Capital Investments. In Basel, closely affiliated with the Swiss Bank Corporation, one might mention the Swiss Metal Corporation and the Schweizerische Gesellschaft für Anlagewerte and others. The Motor-Columbus, Corporation for Electrical Enterprises, is the large holding company of the Brown-Boveri concern, the largest electrical manufacturers of Switzerland.

Each year, Switzerland has a large surplus of savings available for investments. A great part of it before the war was exported abroad, so that the foreign investments were estimated in 1914 to aggregate about one billion dollars, which represents about one seventh of the estimated aggregate national wealth. The investment trusts absorbed a considerable part of this surplus and obtained up to 1914 good profits on these investments. As already pointed out, they sometimes formed a link between banks and industry. In this sense they are a supplementary part in the banking structure of the country and are significant.

Most of these trust banks were severely tested during and espe-

cially after the war, and few of them escaped without heavy losses, resulting largely from the depreciation of their large foreign security holdings. In the five years following the war these banks showed losses aggregating about forty-five million dollars which is more than 40% of their total investment of 1921. Whether this heavy price was worth the benefit derived from these banks in years preceding the war may well be questioned. Swiss bankers, however, affirm that it was, despite the fact that some of these banks had to reorganize.

The space allotted to this chapter is too limited to describe each banking group in detail. It has already been pointed out that the Swiss banks transact a great variety of business and that there are no clear lines of demarcation between the various groups. The division into groups, as mentioned above, is in part an arbitrary one made for statistical purposes and it will be well to keep this in mind in any study of Swiss banking.

Local Banks. The banking statistics of the Swiss National Bank list 77 local banks for the beginning of 1926; 70 of which were corporations and 7 coöperative banks. The term "local banks" includes those institutions which have purely a local importance and transact partly commercial and partly savings bank business. The customers of these banks are the small tradespeople, artisans, local business and real estate people who do some current business but have no need for the extended facilities of the large banks. The deposits of these banks are about five times as large as their capital and surplus. In 1925 their deposits were received as follows: loaned from other banks about 8%, from current account depositors 27%, from other depositors 10%, from savings depositors 24%, and through the issue of debentures 31%. About 9% of their resources were kept in cash and with other banks, and 10% in portfolio; about 37% were loaned at short term, 7% at time and 23% on mortgages and about 9% were invested in securities.[13]

These banks may easily be compared to the average American state bank with all its advantages and disadvantages. They give individual service but are subject to the fluctuations of local business. They often lack the capable and conservative management which the large banks possess and frequently find them-

[13] Statistical Publications of the Swiss National Bank for the year 1925.

selves involved with local business enterprise. It is this group of banks that has shown in the past, and especially a few years before the war, the greatest number of failures. The active competition of the big banks is making inroads into their number; and to an increasing extent they are merged, to be continued usually as a branch office of the absorbing commercial bank.

Savings Institutions. The oldest savings bank in Switzerland dates back to 1786. It was a mutual savings institution established mainly for the purpose of the safe-keeping of money and only secondly for investing purposes. There are now more than twenty-one savings institutions which are over a hundred years old. These institutions were of purely local importance but, as opportunities developed, many of them did not hesitate to transact also some current commercial business. The bank statistics list for the beginning of 1926, 58 loan and savings banks and 116 straight savings banks, 67 of which were corporations and 82 coöperative institutions. These banks operated in 1925, with a capital and surplus amounting to 11.20% and 7.28% respectively of their deposits, the latter being represented by 55% and 77% respectively of savings deposits and by 30% and 18% respectively of issued debentures. They invested 17% and 4% of their resources respectively in ordinary loans, 14% and 5% respectively in time loans, and 51% and 71% respectively in mortgage loans and 8% and 13% respectively in securities.[14] These figures do not vary so greatly from those of an American savings institution except, of course, that the American banks do not issue their own debentures. In Switzerland, savings may usually be withdrawn on demand or at a short notice if the amounts are large, and interest is paid from the day of deposit. About 75% of the savings show no movement and nearly the same percentage is loaned on mortgages. The aggregate savings held by the banks (including the issued debentures) amounted at the beginning of 1926 to about 8,400,000,000 francs ($1,621,000,000) which is nearly one fifth of the estimated national wealth. Only 1,400,000,000 francs of this amount were held by the loan and savings and straight savings banks against 3,200,000,000 francs held by the cantonal banks.[15]

[14] Statistical Publications of the Swiss National Bank for the year 1925.
[15] *Ibid.*

Legal Regulation of Savings Bank Investments. Under the heading " bank legislation " it has already been mentioned that 11 cantons have established regulations defining the investment of the savings deposits and their prior lien and requiring periodical publication of the balance statements. However, the laws do not limit the activities of the banks and most of these institutions carry on mixed activities. Some of the laws, with their strict requirements for part investment in mortgages, have had the result of reducing the liquidity of many of these banks. The debentures which are nothing else but time deposits are not subject to law and have no prior lien, and the protection is therefore incomplete. On this and other grounds the laws are opposed by many bankers.

Auditing Associations. In some states as a result of the legislation and in others in order to forestall any further governmental interference, the banks themselves established so-called " Auditing Associations " which provide for a regular examination of the accounts of their members. In 1921, the banks under discussion formed an " Association of the Swiss Local Savings and Loan Banks " for the purpose of protecting their mutual interests. The membership in 1925 was 44. The Association has its own auditing organization at the disposition of its members.

Special Mortgage Banks. At the beginning of 1927, Switzerland had 18 special mortgage banks. Fourteen of these institutions were corporations, three were state-owned banks, and one was a coöperative institution. The smallest mortgage bank showed at that time a capital of 1,000,000 francs ($193,000) and the two largest banks, each one of 30,000,000 francs ($5,790,000). The aggregate amount of outstanding mortgage loans of these banks was then 1,630,792,000 francs ($314,000,000) as compared with an aggregate of 5,901,798,000 francs ($1,139,000,000) of all the banks.

The oldest mortgage bank in Switzerland dates back to 1756, some one hundred years before cantonal banks were established for the purpose of granting long-term land credits. Most of the existing special mortgage banks have been formed during the second half of the last century.

About 69% of the deposited funds held by the mortgage banks resulted at the beginning of 1927 from the sale of debentures and

about 21% from savings deposits. Their current assets amounted to about 3.8% of the total resources and the mortgage loans to about 84.8%.[16] There is nothing particularly striking about these figures, especially for a country that has no banking legislation.

MORTGAGE LOANS OF CANTONAL BANKS. Two points, however, deserve mention. One concerns the cantonal banks, the other one the debentures. When discussing the cantonal banks we have already pointed out that about 40% of the aggregate mortgage loans of all the banks are investments of the cantonal banks. Their mortgage loans have nearly trebled within the past twenty years while those of the special mortgage banks have scarcely doubled. The reasons for this are probably the better terms made by the state institutions by reason of their state guarantee and tax exempt features. This seems to prove that efficient state banking is not an impossibility, and confirms the experience had in many other countries, including the United States, that mortgage banking may with advantage be carried on by governmental or at least by semi-governmental institutions, provided political influence and bureaucracy can be eliminated.

The issue of long-term bonds is practiced by mortgage banks all over the world. The characteristic feature of the Swiss banks, however, lies in their financing of mortgage loans through the issue of short-term debentures which mature from within one to five and occasionally within ten years. It is rather an unfortunate characteristic since it creates an unstable situation in the land mortgage credit market. Short-term obligations imply also short-term mortgage loans, or at least a two-sided arrangement relative to the adjustment of interest rates in case of any change. This possibility of change within a comparatively short time makes for serious instability. The Swiss investor is accustomed to these short-term debentures which are not quoted on any exchange and he will prefer them to long-term bonds. But while in periods of stable or declining interest rates no difficulties arise, the reverse, however, applies if interest rates rise. This has been the case since the beginning of the war, when it happened that the interest margin between the rate received on the loans and the one paid on renewed debentures was so small that the banks often had to operate at a loss. In some instances they

[16] Statistical Publications of the Swiss National Bank for the year 1926.

feared that they would be unable to find buyers for a refunding issue and were compelled to make special arrangements for a prolongation.

Proposed Mortgage Legislation. The failure of this system has been evident for many years. Even towards the end of the last century the suggestion came forward to establish a central mortgage bank, and since then many other suggestions were made. The high interest rates of the immediate post-war period induced the " farmers' party " to indorse legislation that would permit a better stabilization and, as a result, a bill was placed in the hands of the two Houses with the following main provisions:

The act creates a mortgage bond of standard form which carries no redemption right for the holder and may be called by the issuing bank from within five to ten years after the date of issue. The banks which intend to issue these bonds have to obtain the authorization of the Federal Government. The permission is granted to institutions which are incorporated mortgage banks with a capital of at least 8,000,000 francs ($1,544,000) or to central mortgage banks, either corporations or coöperative banks, with a capital of at least 5,000,000 francs which exclusively have been established by and carry on business with other banks. The mortgages which serve as collateral for the issued bonds have to be entered in a special register and kept separate and have to conform to certain requirements. The banks which issue mortgage bonds are to report monthly to a Federal inspector who has power to supervise them and to examine their accounts.

As in the case of most pieces of legislation, the act is a compromise between extremely contrasting views. The majority of the experts had demanded that one single central mortgage institution be established possibly with a monopoly in the issue of mortgage bonds. It was held that the market was too small to absorb a great variety of mortgage bonds. However, the cantonal banks objected strongly to this proposal and maintained that, as a result of their privileged position (state guarantee), they preferred to establish an institution of their own to which no other banks would be admitted. In 1923, 84 local mortgage and savings banks promised to form eventually a central mortgage bank. Thereupon, the new bill was drafted.

Credit Unions. The so-called " Raiffeisen " banks have developed in Switzerland since about 1900. These are mutual loan and savings associations with a purely local character. In 1925 there were 370 institutions of this type which formed the " Association of Swiss Loan Banks " with a central office in St. Gall and a membership of 29,607 in 1924. The total resources amounted in 1924 to 148,800,000 francs (about $30,000,000).

PRIVATE BANKS

The private banks in Switzerland have never occupied the important position held by the private banking institutions in the United States or in England and in some of the continental countries. The Swiss private banker administrates and safeguards private estates. He is the confidential investment adviser of the wealthy classes and the curator of old family estates. He also transacts a stock exchange business. As a rule he does not underwrite loans and grants no commercial banking facilities.

While private banks were the first banks in the country, from the beginning they limited themselves more or less to the activities which have just been mentioned and throughout their history their attitude was more one of striving to conserve existing wealth than of creating new wealth through the financing of trade and industry. In this era of giant capitalistic organizations this is perhaps the proper task of the private banker, who very often is not strong enough to compete with the big institutions.

The Swiss private banks, in any case, suffered from the competition of the rapidly growing commercial banks. A great number of private banks surrendered and were taken over and continued as branch offices by the big commercial banks, while others were dissolved. In some places the private bankers established institutions of their own for the purpose of fighting outside competition. In Geneva, for instance, a few private bankers established in 1849 something like an investment trust and in 1872 an underwriting house. In 1890 they formed as their underwriting and holding organization the " Union Financière de Genève " which was one of the founders and still is an active

member of the "Cartel des Banques Suisses" (the underwriting organization of the commercial banks). In Basel some of the private bankers established a commercial bank but lost the control later on and found themselves competing later with this same institution.

The competitive struggle between these different types of banks began in Switzerland at the time that the big banks developed their trust and investment services and it is along these lines that competition is still taking place. There is no doubt that as the big banks develop their trust and investment facilities steadily they thereby threaten the existence of the private banker. On the other hand, however, they sometimes lack the personal and individual service of the latter. This personal and perhaps even traditional contact forms the foundation of the existing private banks in Switzerland.

The greatest number of private banks is to be found in the strongly individually-minded western part of the country, especially in Geneva. Some of the houses there are over a hundred years old, and their clients rank not only among the Genevese families but come also from France and other countries. They developed the Geneva Stock Exchange and had always close connections with the French "Haute Finance." These banks still enjoy a high reputation all over Europe. Basel too, shows a comparatively large number of long-established and well-known private banks which nearly exclusively manage the affairs of some old family estates. Zurich does not have so many private banks, although their number has been increasing in recent years.

THE CENTRAL BANK

Issues of Discount and Cantonal Banks. Up to the centralization in 1907, the largest part of the bank note issue was handled by two groups of banks, namely by the so-called "discount banks" and by the cantonal banks. The discount banks were commercial institutions similar to the large national banks in the American cities. Most of them were established during the second quarter of the last century for the purpose of accommodating the expansion of trade. They discounted the bills of the local

business people, made loans and issued notes which were secured by cash reserves (usually not below 40%) and by their portfolios. Most of these banks were very liquid and kept high reserves, since the amount of notes issued by them remained low. They developed well, but in later years lost their importance as issue banks on account of the rapidly increasing note issue of the cantonal banks which have been discussed under a separate heading. Under the blessings of a state guarantee these latter institutions were both mortgage banks and issue banks at the same time, a rather interesting combination. However, it can be said, especially in the case of the large ones, that they kept a very liquid portfolio and managed their note issue rather with a view to the general public needs than with an eye on individual profits. Many of them developed within their local territory, aside of the discount banks, to something like central banks. Their circulation increased rapidly and the development of their commercial activities kept pace. Yet, conditions were still too narrow for these banks to develop discount policies.

Regulation of Note Issue by Law of 1881. Up to 1881 there were 36 banks that issued notes. The notes of each bank were different and since mutual acceptance was neither obligatory nor practiced, the notes had purely local circulation. Little coöperation took place among the banks. Like the national banks in the United States years ago, they had no agency with which they could rediscount in times of stringency and they refused to touch their reserves when it might have been necessary. Owing to the existence of the Latin Monetary Union the banks sometimes rediscounted in France. However, when the Franco-German war broke out in 1870 this recourse was impossible, and an extremely severe stringency occurred which aroused public opinion and led finally to the passing of the law of 1881. This left the old free banking structure but regulated the note issue and subjected it to governmental supervision. It limited the circulation to double the paid-up capital against a reserve of at least 40% in precious metals and the rest in bills of exchange or securities. A tax had to be paid on the circulation and regular reports had to be made to the government. The notes had to be uniform in print and their acceptance for payment was made compulsory for all the issue banks.

Lack of Coöperation Among the Issuing Banks. The Act favored the cantonal banks strongly, and brought a rapid development in their issue activities at the expense of the note issue of the discount banks. Unfortunately both the law and the practice of the banks had shortcomings. Each bank had and followed its own policy, sometimes with little regard to the policies of the other banks. Their interests were too different. This lack of coöperation made any uniform and effective policy impossible. Some agreements were made between the banks, but they were ineffective. Under these circumstances the circulation was extremely inelastic, especially due to the rigid issue limits and the tax imposed on the maximum amount of issued notes. The portfolios contained quantities of finance bills. No foreign exchange control was possible and in periods when the French franc was at a premium, heavy drainage of silver to France took place at the cost of thousands and thousands of francs to the Swiss issue banks.

Struggle for Centralized Note Issue. Such conditions could not last and in the last decade of the century an active fight began for the centralization of the note issue. The struggle passed through a number of stages, such as the opposition between the Federalists and the Unitarists (Western and Eastern parts of the country), between the Federal Government and the cantons which demanded participation in the profits as a compensation for the business taken from their cantonal banks (fiscal nature), between the socialists and the conservatives (entirely state-owned or private institution) and between the cities of Berne and Zurich as to the location of the bank. In 1891 the Federal Statutes had been changed as to allow the Federal Government to establish a central bank with a monopoly of note issue. In 1894 the Administration presented a bill to Parliament creating a state-owned central bank. It was passed by both Houses, but rejected by the people in a referendum vote in 1897 on account of its state ownership features. A compromise proposal establishing an institution partly owned by the Confederation, the cantons and the public was introduced two years later but failed to get approval because the Upper House wanted to have the bank located in Zurich and the Lower House in Berne. In 1904 a new bill was introduced. It passed both Houses on

October 6, 1905, and went into effect on January 16, 1906, creating the "Swiss National Bank."

THE SWISS NATIONAL BANK. The Swiss National Bank (Banque Nationale Suisse, Schweizerische Nationalbank, Banca Nazionale Svizzera) is a corporation with a capital of 50,000,000 francs ($9,650,000). Two-fifths of the stock were issued to the cantons, one-fifth to the old banks of issue and the remaining two-fifths to the public. The seat of the administration and of the department for note issue, metallic reserve and business with the Government is at Berne. The management of the discounts, giro, accounting and auditing departments is located in Zurich. Each canton is entitled to have within its territory at least one branch office or agency of the bank. The bank is not subject to any state taxes.

"NOTE, GIRO AND DISCOUNT BANK." The bank has to regulate the circulation of currency and to control the foreign exchange position of this currency. It is a "note, giro and discount bank" authorized:

1. To issue bank notes.
2. To discount domestic bills, promissory notes and checks bearing two signatures and with maturities of not over three months.
3. To deal in foreign currency bills.
4. To grant loans for no longer than three months against collateral (share collateral excluded).
5. To accept deposit accounts bearing no interest (except on government deposits).
6. To regulate and practice giro transactions, clearings, orders of payment, and collections.
7. To buy for temporary investment foreign and domestic government bonds and to buy and sell securities for third parties.
8. To buy and sell precious metals and to issue gold and silver certificates.
9. To give safe custody facilities.
10. To accept subscriptions for State and Federal issues.

The note issue is not limited. The precious metal reserve is not to fall below 40%, except under special circumstances when,

with the permission of the Federal Government, it may temporarily be reduced to $33\frac{1}{3}\%$. The non-metallic cover shall be composed of domestic discounted bills and drafts on foreign countries, checks, Federal Treasury bonds, promissory notes and by demand deposits abroad. The profits are distributed as follows: 10% to surplus (maximum 2% of paid-up stock) a dividend of 5% on the paid-up capital stock (with eventual supplemental dividend of 1%). The remainder goes to the cantons in proportion to their population and their previous share in the note issue.

The supervisory and administrative authorities are the:

1. Assembly of stockholders (powers somewhat restricted).
2. "Bank Council" (40 members, 15 appointed by stockholders and 25 by Federal Government; President and Vice President by Federal Government).
3. "Bank Committee" (7 members elected by Bank Council).
4. "Local Committees" (3 to 4 members elected by Bank Council).
5. Auditing Commission (appointed by stockholders).
6. Management (3 directors appointed by Federal Government on recommendation of Bank Council).

The Bank Council makes propositions to the government and to the stockholders; it decides on all general transactions over five million francs and on credits over three million francs; it appoints the officers and fixes the salaries. The Bank Committee is the actual executive body of the bank.

The monopoly of the bank over the note issue is to be renewed every ten years and it was extended in 1926 until 1937. The law obliges the bank to handle all the cash transactions of the government free of charge.

While the bank is organized as a corporation and no stock is owned by the Federal Government one cannot help noticing the strong hold which the latter has on the bank in being allowed to appoint the officers and the majority of the members of the Bank Council and in having submitted for its approval all the regulations, the reports and the yearly statements. The bill creating the bank is a compromise between all those antagonisms

which have been mentioned, and it can only be understood and explained through a study of the history of the note issue.

The Swiss National Bank in Operation. The Swiss central bank, similar to the Federal Reserve Banks, was established at a time when the credit organization of the country had already been fully developed and when most of the important European countries had centralized their note issue for many years. Thus the place which the bank would have to take was clearly indicated, and its activities were limited from the beginning. It could not possess such a strong hold on the credit supply of the country as developed in the hands of the Bank of France and of the Reichsbank. There was no question of competition with the big commercial and state banks. The main task of the bank was to be a "bank of banks," the foundation on which other banks could rely in times of stringency; an institution which by the means of a sound reserve, discount and exchange policy would give to economic life the stability necessary for a sane development.

Contact of Central Bank with Money Market. What is the duty which the bank owes to the money market and by what means can it influence the credit supply? There is no single, large money and capital market in Switzerland. Money markets exist in Zurich, Geneva and Basel, but none of them is extremely important, with the exception of that in Zurich perhaps. Business and stock exchange transactions, while proportionately to the size of the country are on a large scale, move actually within narrow limits if compared with the big money centers of the world. The big commercial banks are very strong in their resources as a result of the large international business which they have done since the war; they are liquid and have usually no great difficulties in satisfying the needs of the market. Their call loans represent only something like one per cent of their total resources, which certainly is an extremely low amount, while the bulk of their liquid assets are held in bills and on call deposit with foreign correspondents and about 4% in cash. This cash reserve is usually large enough for their normal needs, and only in time of strong business activities or of seasonal demand do the banks discount their paper actively at or borrow from the central bank.

These discounts and the collateral loans are the only means more or less through which the Swiss National Bank, under normal conditions, maintains contact with the money market. The bank has a discount rate for eligible bills and a so-called " lombard " rate for the collateral loans. The lombard rate is usually 1% above the discount rate. When a bank or an individual that keeps a giro account with the central bank presents its or his paper for discount, the proceeds will be credited to its or his giro account from which it may be transferred at once upon instructions from the depositor to some other giro account or withdrawn, which necessitates an immediate note or currency issue. No bank is required to keep a reserve with the central institution as under the Federal Reserve System. The central bank, therefore, depends for its earnings in part on the balances left in the giro accounts.

While the Federal Reserve Banks keep in contact with the money market either through the discounting of bills at the official rate or through their open market operations, and the central banks of England, France and Germany largely through discounting at official and private rates, the Swiss National Bank handles but a limited amount of open market operations and does not quote any private rates. It is for this reason that its influence on the money market remains limited. Especially in slack times when good commercial paper is scarce and when the open market rates are very low; the contact with the other banks is very loose and any effective discount policy at such times is out of question. Since the beginning of the war, however, a certain contact was maintained through the sale of government treasury notes to the market and through an active business in foreign exchange.

Note Issues. The table on p. 1112 is the latest available annual balance sheet of the Swiss National Bank (December 31, 1927). (The bank, of course, publishes weekly statements which, however, are only summaries.) The figures are given in millions of francs.

The Swiss National Bank opened for business on June 30, 1907. By 1910, it possessed the complete note monopoly. From then on until after the World War the circulation increased steadily. Up to 1914, the increase was slight but at the end of July and in August, 1914, it increased by about 69%. By 1917, it had

Assets		*Liabilities*	
Unpaid share capital	25.0	Capital stock	50.0
Cash reserve (including bullion and gold in mint)	496.9	Surplus (reserve fund)	7.9
Gold deposits abroad	84.5	Reserve for note printing	1.0
Portfolio	370.7	Reserve for war and other taxes	1.3
Bills in process of collection	1.0	Circulation	917.4
Collateral loans (lombards)	78.5	Deposits on giro accounts	123.8
Sight balance abroad	33.8	Deposits of Federal Government and others	27.6
Other correspondents	34.6	Sundry deposits	10.0
Balances due from Postal Check Service	1.2	Outstanding transfer orders and checks	.7
Various loans	4.8	Rediscounts	1.0
Investments	9.2	Net profit	6.8
Coupons	.8		
Accrued interest on investments	.2		
Bank building	6.3		
	1,147.5		1,147.5

doubled, by 1918 trebled and by 1920 nearly quadrupled. In 1922, it declined by about 28%, but increased again in the later part of the year as a result of a proposed referendum for a capital levy. Since then it has fallen off to a level which in 1928, was still more than three times as high as that of 1910. These figures show clearly that Switzerland has not been spared from inflation. In 1920, the Swiss wholesale price index of Doctor Lorenz was as high as 325.6, 1914 being taken as 100. By the end of 1921, it had declined to 178, and by the end of 1926 to 146. In the face of this considerable decline the slow and comparatively small decrease in the note circulation is very striking. The Swiss National Bank, therefore, studied the situation during 1927 [17] and came to the conclusion that this small decrease was due to (a) a 55% higher price level, (b) a 15% normal growth in economic activity, (c) a 15% higher wage level than in 1913 and (d) higher cash reserves held by the banks and hoarding of notes by individuals to the extent of 15%. Previous to this study the statement had often been made that the high circulation level was due to a reduced velocity of circulation and extensive hoarding of notes abroad.

[17] Der Zahlungsmittelumlauf der Schweiz im Jahre 1926 im Vergleich zur Vorkriegszeit. Mitteilungen des statistischen Bureau der Schweizerischen Nationalbank.

The lack of elasticity which had been characteristic of the old note issue system disappeared at once with the establishment of the new bank. The circulation rose and fell along with the needs of the market, reaching usually a high peak at the end of the year and a low in February and June.

Reserves. From the beginning the bank built up a strong reserve, consisting mostly of gold. Up to 1914 the yearly average reserve ratio was never below 66%. The outbreak of the war brought a low mark of 46.93% (on August 5, 1914) against a high of 78.2% a few weeks earlier. The following years show an average of from 70.5% to 74.1% with the exception of the years 1918, 1919 and 1920 with an average of 58.9%, 57.0% and 67.1% respectively. The lowest ratio ever shown was 45.18% on November 12, 1918, when the circulation increased rapidly on account of the general strike. In 1918 an amendment to the law was adopted, which had been suggested before 1914 and drafted with the experiences of 1914 fresh in memory; it permitted a $33\frac{1}{3}$% reserve instead of the regular 40% precious metal reserve, provided special circumstances were existing and government authorization had been obtained.

The bank bought most of the gold directly in London contrary to the practice of the old issue banks, and made its purchases with a view to industrial requirements and to the general currency situation. The silver drainage to France stopped at once, though the silver reserves increased somewhat since the beginning of the war due to the great influx of five-franc silver pieces from member countries of the Latin Monetary Union. The silver as far as the reserve is concerned, however, may never exceed one-fifth of the total legal reserve.

Discount Rate and Portfolio. The potentialities of the discount policy of the Swiss National Bank have already been sketched. The discount rate is fixed by the three managing directors after hearing the recommendations of the Bank Committee (which can only be disregarded upon a unanimous decision of the three directors), after a careful examination of its own position and of such factors as the money and capital markets, the general economic situation, the foreign exchange position and the possible coöperation with the banks of issue of other countries. It has been the tendency to keep the rate as stable as possible,

sometimes even at the risk of losing contact with the market. From January, 1915, to October, 1918 (4½%), and from July, 1923, to October, 1925 (4%), for instance, i.e., for 3½ and 2¼ years respectively, the rate remained unchanged. During the first years, due to the Latin Monetary Union membership, the discount rate moved closely with the rate of the Bank of France. But the war changed the situation entirely.

As a result of the suspension of gold payments during the war and of the huge inflation the discount rate lost its regulative power. Good trade paper was scarce and the portfolio became filled with Government Treasury bills. In the years preceding the war the bills discounted had averaged in amount around 6,000 francs and in maturity about 25 days. From 1915 to 1922 they averaged in amount 38,263 francs and in maturity 66 days, and without the Treasury bills 13,423 francs and 34 days respectively. These figures give a splendid illustration of the entirely different character of the portfolio since the beginning of the war. At present it again shows something like the high pre-war liquidity. While the old banks of issue had carried large amounts of finance bills in their portfolios, the central bank established at once a much higher standard of eligibility for discounts and succeeded in reducing the percentage of finance bills held. It has taken the same attitude in recent years, contrary to the wishes of many of the commercial banks which strongly object to this close scrutiny in view of the limited supply of domestic trade paper.

At various times before the war as much as one-third or even more of the amount of bills discounted were foreign bills, mainly sterling and French franc bills. These foreign exchange holdings formed a very useful instrument for the foreign exchange policy of the bank. During the war the large dollar engagements of the Federal Government necessitated a comparatively large foreign portfolio; afterwards, however, the amount of eligible foreign currency bills was very small and the holdings were low. The increasing depreciation of some of the currencies of neighboring countries gave support to this tendency. With the return of a number of countries to a gold basis conditions changed again and in 1926, for instance, the average foreign bill discounts were nearly twice as large as the domestic holdings. This throws an interesting side light on the domestic trade conditions and the foreign exchange policies and activities of the bank.

Other Activities. The collateral or lombard loans of the bank have never been very large. The have varied in recent years from within 5% to 7% of the total resources of the bank. One of the strong defects of the old issue system had been the inability of the banks to coöperate for the purpose of facilitating payments and to thereby regulate the circulation. The new central bank immediately gave its attention to the better development of the giro system, i.e., payment transfer system and has well succeeded. The transfers have tripled within the last 15 years. The balances left in these giro accounts, on which no interest is paid, usually represent an amount fluctuating around 10% of the total resources of the bank.

In 1907, Switzerland had but two clearing houses; in 1913 the central bank had increased their number to six and later to eight, acting in each of these cities as clearing agent. The clearing turnover, adjusted to the different price level, has doubled within the last 15 years. — The deposits in current account have never been very large.

For the first years of its existence the earnings of the bank remained far below expectations, and the Federal Treasury had to advance the contributions to the cantons provided for by the Bank Act. This caused much criticism and various amendments were made in the Act to permit the freer use of its deposits. The controlling position which the bank occupied during the war increased its earnings considerably, and allowed it to pay off the advances made by the Government and to make the contributions to the cantons regularly. The dividend paid is 6% and the average percentage earned (net) in the years 1923–26 on the paid-in stock was 24.83%.

In a discussion of the activities of the Swiss National Bank it is necessary to mention the great services rendered by the bank to the Federal Government. It is compelled by law to handle all the banking business of the Government free of charge and has to pay interest on the Government deposits. The amount of these transactions has been enormous, especially during the war. In 1926, the aggregate amount of debits and credits on government accounts amounted to over two billion dollars which is about 80% of the aggregate clearings turnover of the whole country for that year. (The latter, of course, do not include the giro transfers which were about five times the total clearings!)

Summary. In reviewing the development of the Swiss National Bank up to 1914, it can be said that the bank succeeded in overcoming most of the defects of the old note issue system. It developed the discount market and through a skillful discount policy it regulated the note circulation which became elastic thanks to the high reserves held. It facilitated payments in developing the giro transfers and establishing clearing houses. It laid the beginnings for a foreign exchange policy and rendered great services to the Government. On the whole, the bank developed rapidly and solidly into its assigned place as a " bank of banks " and proved of invaluable assistance in the years that followed. Without the central bank the crisis of 1914 would probably have been much more severe.

During the war the bank has been of very great assistance in financing the huge governmental needs, in managing the Federal Loan Institution and in acting somewhat as agent between the Government and the banks. Like most of the other central banks it could not prevent governmental interference and resulting inflation. These points will be discussed further in the next section.

Since the war, as in most countries, the main endeavors of the central bank have been towards a return and a maintenance of the gold standard.

THE SWISS BANKING SYSTEM SINCE 1914

The Measures Taken in July and August, 1914. The talk of war had been going on for years before 1914. The problem had taken on a real aspect and as a result European central banks had made preparations, by the establishment of large gold reserves and the printing of huge stocks of bank notes for emergency purposes. The Swiss central bank had acted along these same lines. At the beginning of 1914 several small banks had failed and there developed a feeling of distrust. Towards the end of July, after the Austrian ultimatum and the subsequent declaration of war on Serbia, rumors began to spread, people rushed to withdraw their savings and deposits and a regular " run " took place. The banks were besieged and police reserves had to be called out. Gold and silver disappeared from circula-

tion and were hoarded. As a result the central bank informed its giro depositors by letter on July 28, that it would break off relations with any firm that exported specie. At the same time all the banks were asked to coöperate and maintain a strong reserve.

On July 30, at the request of the central bank, the Federal Government declared the bank's notes legal tender and authorized the issue of twenty-franc bills and a few days later also of five-franc bills. The banks immediately began to rediscount large quantities of bills of exchange with the central institution. On July 30 the discount rate was raised from $3\frac{1}{2}\%$ to $4\frac{1}{2}\%$. The next day it was increased to $5\frac{1}{2}\%$ and on August 3 to 6%. The note circulation increased in the last week of July from 268,000,000 francs to 409,000,000 francs and the reserve ratio declined from 74.3% to 48.3%, while the loss of precious metal up to July 30 amounted to 17,500,000 francs. The discounts and loans for the same week amounted to 175,000,000 francs. The "run" continued and on August 2 the central institution, with the permission of the Federal Government, requested the banks to limit their payments to individual depositors to 200 francs and to savings depositors to 50 francs and to make payments to firms only against presentation of their wage lists. On August 5, the Federal Government declared a moratorium until August 31, 1914. All these measures together succeeded in stopping the rush and the increase of circulation in the first week of August was only 21,000,000 francs. The hoarding of coins and the lack of notes in small denominations caused the bank to issue, with the consent of the Government, on August 14, Federal Treasury certificates of 20, 10 and 5 francs for which it had to provide the same reserves as for its own notes. On August 31 the central bank increased the discount lines of the banks by about 40% and reduced the discount rate on September 10 from 6% to 5%. After the second week of September, 1914, conditions became quieter.

In glancing back at these measures it may be said that the central bank succeeded in overcoming the difficulties, but as in most other countries, it did so only with governmental assistance and created thus an influence from which it had great difficulty to free itself. The action of the bank in bringing about a limitation of payments has been strongly criticized, and it probably

merited severe criticism because its effects came close to a suspension of payments. There is no doubt that a further increase in the discount rate would have put a similar check on excessive payments, without, however, injuring the prestige of the institution. The actual reason of this extreme measure was the rapid exhaustion of the supply of bank notes which the bank had on hand.

THE FEDERAL LOAN INSTITUTION. With the exception of the Bourse of Geneva, all of the other stock exchanges had been closed in August, 1914. As lending activities of the central bank were restricted by law to a limited type of collateral, the need was felt for an agency that could grant credit on other types of collateral until the return of normal conditions. On August 15, 1914, Dr. Frey, the President of the Crédit Suisse proposed to the Federal Treasury the establishment of a loan institution. This proposal, however, did not enjoy the approval of the cantonal banks which feared the loss of business, and as a result the central bank worked out a counter proposal for a Federal Loan Institution which was accepted by the Federal Government on September 9, 1914. Two weeks later (on September 21, 1914) the new institution opened for business with offices in eight cities.

The Federal Loan Institution was a separate legal entity fully owned by the Federal Government. It was established as a temporary agency for the purpose of granting such collateral loans to banks, business and agriculture which, as a result of charter restrictions, could not be made by the central institution. As a governmental bank it was not to compete with the private institutions and was to be liquidated as soon as conditions would permit it. It was managed and operated by the central bank although all its books had, of course, to be kept separate from those of the central institution.

The authorized activities of the Federal Loan Institution were confined to the making of loans against promissory notes maturing within one to three months secured by the collateral deposit of debentures, bonds, stocks, savings passbooks, mortgage deeds, raw materials and life insurance policies, the necessary funds having been obtained through the issuance of loan certificates of 25 francs each, which were legal tender and not redeemable in metal or bank notes. The amount of certificates, that could be circulated, was limited to 50,000,000 francs and later

to 100,000,000 francs, and was never to exceed the aggregate amount of loans made by the institution. Authority was given to the central bank to include such certificates in the non-metallic note reserve. Loans could be made to banks and individuals, as well as to public bodies, states and municipalities, the discount rate, as a rule, being about one-half of one per cent below the lombard rate of the central bank.

Although the bank developed slowly at the beginning, its outstanding certificates and loans reached a peak of 55,000,000 and 58,000,000 francs respectively by the end of March, 1916, but fell by the middle of the following year to about 20,000,000 and 25,000,000 francs respectively. After that time they fluctuated between 20,000,000 and 30,000,000 francs up till 1922, when they declined considerably. In the following year they increased again, and finally were practically liquidated in 1924. By far the largest part of the loans were made to banks, especially to the mortgage banks which had met with great difficulties in the sale of their debentures on account of the rising interest rates. Without the assistance of this institution many of the mortgage banks would probably have been unable to carry on business. However, trade, industries and individuals borrowed heavily in certain years, both banks and business depositing mostly mortgage deeds as collateral security for the loans. With regard to the geographical distribution of the credits it may be said that Zurich remained at most times the largest borrowing center. The bank was fully holding its own and accumulated profits which were handed to the Federal Treasury when it was liquidated. Reviewing its work as a whole, it may well be emphasized that this institution rendered great services to the country and formed a very valuable temporary link in the banking structure.

Trade and Industrial Conditions Since 1914. The activities and operations of banks are only a part of the general economic activity of a country and as such they should be considered in conjunction with such factors as industrial and trade conditions, money and capital markets, foreign exchange, and public finance. Only in this wider setting may some of the activities of the banks be explained. A short sketch of the developments bearing on the subjects just mentioned, seems therefore necessary.

Price of War-Time Neutrality. Though usually a favorable factor, the central location of Switzerland brought her during the World War into an unfavorable position. On all sides she was surrounded by belligerent countries which compelled her, indirectly, of course, steadily to watch to her neutrality. She was not in the fortunate position of other neutral countries such as the Netherlands or the Scandinavian countries and Spain, which had access to the open sea and therefore to raw materials, but had continually to negotiate and bargain with the belligerents so as to obtain their permission for the transit of the necessary foodstuffs and raw materials. The price of these permits, in form of credits, will be discussed under a later heading.

Effects of War on Various Activities. The effects of the war on the various lines of activity were not uniform. The hotel industry and all the branches connected with it, the lace and silk industries, the high-class watch and jewelry industry, and others suffered considerably from the ban which was put on luxuries in most countries, whereas industries like those engaged in the manufacturing of machines, leather, food products and similar necessities, exporting products demanded by the belligerents, were fully occupied. During the first two years, while stocks were on hand, the exports increased greatly and in 1916, for the first time in her recorded economic history, Switzerland showed a favorable balance of trade; but from 1916 to 1918 exports fell off again because the importers met with great difficulties in procuring raw materials. From 1918 to 1919 both imports and exports increased on a large scale, but in 1920 the exports began to decline and were followed in 1922 by imports, both of them falling back to the approximate pre-war level, rising, however, again somewhat in the following years. These ups and downs in the foreign trade were a fair reflection of the general economic conditions of the country as a whole.

War-Time Fiduciary Institutions. In 1915 at the demand of both belligerent camps two huge fiduciary institutions had to be established (Société Suisse de Surveillance, called "S.S.S." and Treuhandstelle) to prevent any imported goods from being reëxported to their enemies. The importers were compelled to furnish bond to these organizations, both of which were clumsy and slow in their operation. In 1915 the coal consumers

were compelled to form a "Central Coal Office" which obtained coal from Germany against loans to the German Government. A similar organization had to be formed for coal importations from the Entente countries. To prevent extortionate price demands the Government created a monopoly for various commodities such as grain, rice, sugar, and became a wholesale importer of these commodities, interfering thus with free trade.

The post-Armistice period with its excessive production was followed by a period of severe reaction and unemployment which reached its peak at the beginning of 1922. Many industries suffered heavy losses from the depreciation of the foreign currencies, either directly in their balances or in investments abroad, or indirectly from the competition of these countries. The farm population on the other hand experienced during the war a number of very prosperous years. Since 1922 conditions have again considerably improved but no great and lasting prosperity may be expected in Switzerland until the whole of Europe has been fully stabilized and recovered.

Money and Capital Markets Since 1914. While discussing the developments of July and August, 1914, it was shown that at the outbreak of the World War money rates in Switzerland, like in all other countries, were very high. A few months later, however, the money market became easier and it remained so up to the second half of 1917. The reasons for this ease lay in the uncertainty of the whole situation which induced people to hold funds at call and to handle business on a cash basis, as well as in the absence of the usual large yearly outflow of investment capital on account of the currency fluctuations. The capital market was, of course, quite dull in 1914 and the existing small capital supply, which developed, was readily absorbed by the large Federal Government and Federal Railroad bond issues. As a result the capital market continued very tight and few new private issues could be brought out, and the Confederation floated, therefore, in 1915 a short-term issue of $15,000,000 in New York. The money market, however, remained easy. The official rate for that period was fixed at 4½% but, as has already been explained above, it could not be taken as an indicator of the available money supply. The open market rate, which reflected the situation much

more clearly, averaged for the years 1915, 1916 and 1917 about 2.88%.[18]

In the later war and post-war period the situation changed entirely. From a low of 1⅝% in August, 1917, the open market rate rose rapidly to a high of 5.5% in the last quarter of 1918 and remained high until the summer of 1921. This tightness was mainly the result of:

1. The repatriation of large quantities of Swiss securities from neighboring countries on account of the premium on the Swiss currency.
2. The large credits which had to be granted to the belligerents.
3. The increasing demands of the governmental authorities and municipalities on the money market, as well as of the industrial borrowers.
4. The flight of capital on account of the general strike and the proposed capital levy.

Business shifted from a cash basis to a loan renewal basis and both the money and the capital markets became tight. The Confederation in 1919 again had recourse to the New York market.[19]

Issue and Maturity Date		Rate	Amount
March	1915 1–3–5 year notes .	5%	$15,000,000
August	1919–1929	5½%	30,000,000
July	1920–1940	8%	25,000,000
August	1923–3 year notes	5%	20,000,000
April	1924–1946	5½%	30,000,000

Throughout the war period increasingly high rates had to be paid in the land credit market.

During the deflation years from 1921 on, the rates declined again on account of the inactivity in trade and industry, and remained low. The open market rate fell in September, 1922, as low as 1%. Since then, with some short variation, the markets have remained comparatively easy and Switzerland, together with the Netherlands, has had in recent years the cheapest money of the world.

[18] Annual Review published by the Swiss Bank Corporation for 1915, 1916 and 1917.

[19] These loans were floated in New York by the Swiss Confederation.

The Foreign Exchanges Since 1914. The problem of the currency fluctuations since 1914 and their effect upon the trade and exchange equilibrium is one of the most interesting economic subjects that may be discussed. The space available is too limited to discuss the Swiss franc since 1914 in detail, but it may be said at this point that the Swiss franc, like the dollar, was one of the few currencies that remained throughout the war and post-war period at or around par.

The Exchanges During and Since the War. At the outbreak of the war in 1914 the exchange rate on Switzerland rose in New York temporarily to a premium because of the strong demand for Swiss franc bills of exchange which, unlike the dollar bills, were accepted for discount in London and Paris. During the autumn of that year the franc declined to par and even a little below, and fluctuated around that level throughout the year 1915 and the greater part of 1916. At that time, under ordinary circumstances, gold would have moved from Switzerland to New York, Amsterdam and Stockholm, but the Federal Government had prohibited gold exportations in July, 1915. Both in London and Paris the Swiss franc was at a slight discount during the first few months of the war, while it immediately and increasingly reached a high premium in Berlin and Milan. From 1915 on, however, all of the "belligerent" currencies declined sharply and were at a severe discount in Switzerland. In 1917 the rates on Zurich advanced rapidly in New York and reached in May, 1918, a high of 25.81 as against a par of 19.29, which was an increase of about 34%. The only rate which at that time was at a premium in Switzerland was the rate on Stockholm. The reason for the high premium in New York was due to the "pegging" of the sterling, franc and lira and the embargo on gold exportations from the United States which went into effect in September, 1917. With the "unpegging" of these exchanges in 1919 the franc declined in New York and fell below par, like all other neutral exchanges, largely due to the much lower price level in the United States. In December, 1920, it reached a low of 15.07, probably as a result of the credit contraction in the United States with the ensuing liquidation of foreign exchange holdings. As prices declined in Switzerland in 1921, the franc appreciated again in New York and went in the first part of 1922 to a premium in all for-

eign exchange markets. Gold was moving towards Switzerland and for a short while the Swiss National Bank was making some of its payments in gold. Later in the year the Swiss exchange declined in New York again below par, partly as a result of rising prices in Switzerland, speculative influences and largely on account of a capital levy proposed by the socialists which caused a "flight of capital" from Switzerland. It was rejected, but the franc remained below par until the end of 1924. Since then it has been fluctuating around par in New York, varying slightly in accordance with the seasonal influences, rising usually in summer when the tourists' payments flow back, and declining again in autumn on account of the harvest purchases of Switzerland.

Regulation of the Exchanges. The regulation of the foreign exchanges is in the hands of the Swiss National Bank, as previously mentioned, and there is no doubt that the bank has been doing everything possible to protect the exchanges throughout the war and after-war period. It suggested the gold embargo to the Government; it gave its opinion on the advisability of granting loans to the belligerents during the war and at various times it requested the Government to support the exchanges by floating a loan in New York. This was the case in 1915 and 1919. It also made the arrangements for the redemption of some of these loans. When Swiss industry suffered in 1921 and 1922 on account of competition from countries with depreciated currencies, suggestions were made that the bank should depreciate its currency through inflation, but the central institution took a firm stand and rejected all such proposals. On the whole, its foreign exchange policy has been quite successful and important, perhaps more important than its discount policy.

Since 1925 Switzerland has practically been on a gold or gold exchange standard. Officially the Swiss National Bank is still free to refuse redemption in specie, but in practice it pays out gold and does not oppose any exportation unless special conditions should warrant it. The official return to the gold or gold exchange standard is just a question of time; although for the moment the bank seems to see no special benefit from an immediate return, it may be expected that proper legislation, providing for the formal adoption of one of these standards, will be enacted in the not so far future.

The Government and the Banks. Switzerland was no exception to the rule that in times of emergency the individual welfare has to be subjected to the welfare of the community or of the state, irrespective of the economic justification or appropriateness of the latter's actions. The emergency existed and "emergency" measures (often hasty and therefore ill-prepared measures) had to be adopted. Such measures were taken by all countries, directly or indirectly affected by the war, and Switzerland was no exception. The Federal Government increasingly and of necessity encroached upon the individual liberty and interfered with the free course of economic life. The results were centralizations which often were subject to political manipulations and therefore, while in theory perhaps quite to be recommended, highly inefficient and wasteful in practice. The many natural contrasts, of a political as well as of an economic order, which always exist in a country like Switzerland did not moderate the situation. While many of the actions of the Government (such as monopolies) were no doubt a necessity under the existing circumstances and proved very beneficial to the country as a whole, their abolition or removal after the war was nevertheless greeted throughout the Confederation with great relief.

Costs of War. Although Switzerland was not directly involved in the war she was nevertheless under the necessity of supporting her neutrality by keeping troops along the border which on all sides touched belligerent countries. She thus incurred heavy "mobilization" expenses. As the war continued and became complicated through the application of the economic blockade, the difficulties in importing foodstuffs and raw materials and in exporting manufactured products increased. To secure a proper supply of foodstuffs and goods the Government had to establish monopolies and use all its prestige with the belligerents in the negotiation of free markets for Swiss products. As will be seen later, in most instances such concession could only be obtained upon the granting of large foreign credits.

Federal Receipts and Expenditures. In 1913 85% of the Federal receipts were derived from customs duties. They fell off during the war in face of large deficits of the railways, postal, telephone and telegraph monopolies, while the expenditures in-

creased enormously. In 1913 Switzerland had an average per capita Federal debt of 28.95 francs ($5.58) and in 1921 of 546.07 francs ($105.39). As a result of this increasing indebtedness the Federal Government was obliged to borrow heavily and, like most other governments, took refuge in the discounting of treasury notes with the central bank. These notes were usually withdrawn at a later date and replaced by subsequent long-term borrowing from the public. From November, 1914, on, until 1918, the Government issued nine so-called "mobilization" loans, which were all distributed by a syndicate including all the important banks, headed by the central institution. While some of the notes submitted by the Government to the bank for discount had the character of commercial paper since they resulted from the foodstuff and raw material importations of the Government, the bulk of them, however, were finance paper. It was through this channel that the Government interfered with conservative central bank practice and became co-responsible for inflation. The central bank sold these treasury notes from time to time to the market where they were readily absorbed by the banks.

Although the Government has never directly interfered with banking, it did not hesitate to impress the banks throughout the war with the desirability of close coöperation. At the end of 1915, for instance, it requested the banks not to encourage the investment of Swiss capital abroad. Consequently the government was unofficially, of course, consulted about most of the large foreign credits granted by the banks and, on the other hand, was seeking their advice before entering into loan negotiations of any kind with the belligerents.

Credits to the Belligerent Powers. The first official credit had to be granted in the summer 1916 to France. At the suggestion of the Federal Government a syndicate of Swiss banks was formed which granted to a group of French banks a revolving discount credit of 50,000,000 francs in the form of renewable notes of high-class French industrial firms, to the order of one of the French group members, which in turn indorsed it to the Swiss banks for discount. This credit to one of the allied countries was immediately followed by a demand for credit by Germany, and in September, 1916, a discount credit, similar to the one to France and also in the amount of 50,000,000 francs, had to be

granted by a group of Swiss banks to Germany. It was used for the financing of the German cheese purchases in Switzerland. A second credit for 25,000,000 francs of the same type, but guaranteed by the deposit of Swiss and American securities, was given to Germany in 1917 for account of the "Zentral-Einkaufsgenossenschaft." In 1917 a credit of 30,000,000 francs was granted by the Swiss Government to Austria-Hungary and guaranteed by a consortium of Austrian and Swiss banks.

These officially arranged credits which, with the exception of the advance to Austria, had the character of direct loans of the bank, were followed by much larger and more official credits which, on account of their greater risk, had to be handled by separate financial institutions, especially established for the purpose. As the war continued, the belligerents began to realize that in view of their heavy purchases in Switzerland and of the resulting unfavorable balance of trade, they were in a position to exercise pressure on this neutral country. They, therefore, conditioned the granting of importations from Switzerland and the passage of shipments to Switzerland upon her willingness to make loans, and the Confederation, having no other choice, had to consent.

German Credit of 1917. As a result of negotiations suggested by her, Germany obtained in the spring 1917 a credit of this type for 18,000,000 francs. She, however, considered this advance as too small and an agreement was reached on August 20, 1917, which led to the establishment of the "Kohlenzentrale A.G." (Basel). Through this financial institution Germany obtained credits aggregating about 155,000,000 francs ($30,000,000) and permitted in exchange the shipping of coal to, and the admission of imports from Switzerland. The credit was to be increased in proportion to the amount of coal shipped and had the form of renewable 90-day bills of the German Central Purchase Office, indorsed by one of the large German banks, payable in Switzerland in francs, and discounted at a total cost of about 7%. It was secured by the deposit of German mortgage bonds. The resources of the "Kohlenzentrale A.G." were obtained by the issuance of preferred and common stock in the nominal amount of 137,000,000 francs, a small part of which was held by the banks, while the balance was compulsorily subscribed, by the wholesale coal dealers and con-

sumers and the agricultural export syndicate. It also obtained a discount credit from the large Swiss banks.

Credits to Allies. In September, 1917, a few weeks after the loan to Germany had been arranged, France suggested credits in exchange for permissions of imports and the transit of goods, which led on September 29, 1917, to a temporary agreement permitting a credit of 37,500,000 francs and to a final agreement on December 29, 1917, resulting in the establishment of the " Société Financière Suisse " (Lucerne) in January 1918. This institution was specifically formed for the purpose of handling the loans made to the " Allied Countries," and obtained its resources by the compulsory subscription to its capital stock of:

Export Industries	44,000,000	francs
Banks	10,000,000	"
Federal Government	26,000,000	"
	80,000,000	"

It also was authorized to issue treasury notes not exceeding the amount of its capital stock and obtained a large discount credit from the central bank. The " Société Financière " granted credits to France, England and Belgium and made arrangements for advances to Italy, of which the latter, however, never availed herself.

France obtained credits approximating 152,000,000 Swiss francs ($29,000,000) (including a 30,000,000-franc exchange credit of March 25, 1920) in the form of renewable 90-day Swiss franc bills of prime French industrial firms, indorsed by a group of leading French banks, discounted in Switzerland at a total cost of about 7% and secured by the deposit of gilt-edged French and Swiss securities. England obtained from 1918 on, credits aggregating 84,460,000 francs (about $16,000,000),[20] which were also in the form of renewable Swiss franc bills, indorsed by two of the large British banks in favor of the Exchequer and secured by the deposit of Argentine and Canadian securities in New York. Belgium received from June, 1919, on, loans aggregating 17,350,000 francs (about $3,300,000) [21] in exchange for the authorization of coal shipments to Switzerland. All these loans were fully re-

[20] Allizé, F.: L'organisation des banques en Suisse, 1923. pp. 212.
[21] Ibid.

imbursed by the beginning of 1921 and the " Société Financière " was liquidated in the same year with a surplus of 6,200,000 francs.

Results of Credit Grants to Belligerents. Reviewing these official credits to the belligerents in the aggregate of about $85,000,000 it may be said that, although they were remunerative to the banks and could be liquidated without losses, they taxed the financial capacity of the country very heavily. The purchases to which they gave rise undoubtedly increased industrial activity but caused on the other hand a scarcity in both the capital and the money markets, and thus reacted unfavorably upon the land credit interest rates. It has also been maintained, and apparently with good justification, that these credits were important factors in causing inflation and kept, at a later period, the Swiss franc far above its intrinsic value with a detrimental effect, at that time, on Swiss industries and their exports, the former being no longer in a position to compete with the industries of the neighboring countries on account of the currency depreciations. With regard to the benefits derived from these loans by the borrowers it may be observed that most of these credits did not enable them to support their exchanges, as had been expected, which meant that their reimbursements (with the exception of the British credits) had even to be made with heavy exchange losses.

If one considers that the Federal Government, with the exception of the Austrian loan, did not grant any direct credits, it becomes evident that, although two separate financial institutions had been established, the banks were contributing to an exceedingly large extent to the " national economic mobilization." They collaborated at all times with the Government to the fullest extent and it was largely the result of the well-developed credit organization of the country and of the high prestige of its banks abroad, that the Government was able to negotiate for the supply of foodstuffs and raw materials in exchange for the granting of loans.

With the return to more normal conditions in recent years, the close contact of the war period between Government and banks disappeared somewhat, and there have been instances in recent years where the banks were criticized for their non-

consultive attitude towards the Government when granting foreign loans.

Practically all of the floating debt of the Government has been consolidated and the budget now is balanced.

THE BANKS DURING AND AFTER THE WAR

Under some of the previous headings a few of the war activities of the banks have already been sketched. It is evident that the various developments were bound to affect each group or type of bank differently. The purely local banks naturally had fewer problems to face than the large commercial institutions which handled practically all the international financing of the country. It is the latter group of banks which interests us most under the circumstances.

Reference has already been made to the numerous foreign connections which the Swiss banks had established before the war. These connections formed now a valuable basis for the establishment of the financial contacts which were a prerequisite for any commercial transactions during the war-time. The unexpected outbreak of the war had brought international trade to a sudden standstill. The uncertainty of the situation and the emergency measures which were passed in most countries produced a general lack of confidence and the continuous exchange fluctuations made the situation more uncertain. When the interrupted trade ties were again established they, therefore, passed more closely through the hands of such generally trusted and internationally known intermediaries as the banks and consequently the activities of these institutions increased greatly. As the war relations became more intricate and more complicated, these close relations extended not only to business but also to the Government and the large commercial banks especially, benefited therefrom considerably. At the end of 1913 the seven large commercial banks then listed in the statistics of the Swiss National Bank showed deposits aggregating 1,579,000,000 francs (about $300,000,000), while at the beginning of 1927 the eight largest institutions registered deposits of 4,255,000,000 francs (about $821,000,000) which in spite of the 50% rise in the price level

and the addition of another bank to the group, indicates a remarkable increase.

Foreign Trade Financing. We have already seen that the banks faced the emergency of July and August, 1914, without very great difficulties, mainly by coöperating with the central bank to the fullest extent in its endeavors to protect the gold reserve. Their main endeavors during the months that followed were to find ways and means of rebuilding the broken international trade relations and to arrange for the necessary payments. The fluctuations in the foreign exchanges prevented foreign buyers from putting orders in Switzerland and Swiss sellers from accepting them in foreign currencies. In a number of countries decrees had been passed prohibiting the exportation of capital. To overcome these difficulties the banks were compelled to grant loans in Swiss francs to foreign buyers who expected an appreciation of the value of their currency, or they extended credits to Swiss exporters against the pledging of the foreign currency balances, received as sales proceeds, with some correspondent abroad. Both of these methods presented, of course, under the circumstances considerable risks and required skilled execution. The unsecured loans and the acceptance credits which had often been used before the war for international transactions were replaced by secured and confirmed credits. The irrevocable letter of credit became the usual credit instrument and sometimes special arrangements had to be made to pass payments through the central bank of the importing country which in turn credited the Swiss issue institution for account of the bank of the exporter. The ease in the money market which developed after 1915 increased the deposits at the banks rapidly and was naturally a strong inducement for them to loan freely to trade and industry and thus to stimulate industrial and commercial activities. Without their willingness to extend the large credits needed, both industry and trade would scarcely have profited to as large an extent as they did from the business with the belligerents. The coöperation given by the banks to the Government in making direct loans abroad and in participating in the financial institutions created for that purpose has been sketched in a preceding paragraph and needs no further emphasis here.

Every war year brought new additions to the deposits and con-

sequently also to the loans of the banks, such credit increases rising much more rapidly than the price level. Many of the banking transactions, however, began to take on much more of a financial than commercial (i.e., self-liquidating) character. The loans had to be renewed and, as pointed out before, many of them were secured by the pledge of foreign currency balances. Large payments passed through Switzerland, similar to other neutral states, such as the Netherlands and the Scandinavian countries, for account of the belligerents, the destination and purpose of which, however, remained undisclosed to the Swiss banks. Equally large and increasingly more important, deposits began to flow into the banks from abroad as some of the foreign currencies continued to depreciate. More will have to be said on this score when discussing the after-war developments.

The Investment Operations of the Banks. In the investment field the banks were not less active than in their commercial or deposit line. While the capital market had suffered considerably from the closing of all the stock exchanges, except the one in Geneva, and from the general uncertainty, it again became more animated as investment funds which usually had been flowing abroad remained accumulated at home and as foreign capital began to flow into the country. The large and numerous governmental bond issues had to be sold to the public, followed later by a large variety of state, municipal, railroad, industrial and public utility issues. As the Swiss franc continued to hold to a high premium, large blocks of Swiss securities were repatriated, especially from France and were added to the list of securities to be sold to the public. Many of the banks acted as agents for the liquidation of the large quantities of enemy securities held by the nationals of the belligerent countries, which task was fortunately greatly facilitated as a result of the extensive foreign listings existing at the Swiss stock exchanges, especially at the one in Geneva. Their number naturally increased during the war.

The many investment transactions which the banks handled, both domestic and foreign, had also a stimulating influence on their fiduciary activities, especially on their services for the custody and safe-keeping of securities and valuables. It is believed that in spite of existing export prohibitions, many large foreign estates transferred some of their holdings to Swiss banks and at

a later period, as a result of the debacle of the exchanges, these transfers no doubt became regular and accumulated therefore to large amounts. The handling of estates by the banks, especially by the private banks, increased their appointments as executors or as trustees for the many new corporate issues, and their services in furnishing guarantees or bonds of indemnity for their clients in connection with the many export and import restrictions became very frequent. While the extent of these fiduciary activities probably could not compare with the large trust business handled by the large American trust companies, it should nevertheless be pointed out here that the war greatly stimulated this line of activity of the Swiss banks.

Mortgage Credit. The marked rise in money and capital rates which marked the later war years was bound to affect mortgage and savings banks and investment trusts severely because of their practice of procuring part of their loan funds through the issuance of short-term cash debentures or notes bearing a fixed rate of interest. As these notes and debentures periodically matured, higher interest rates had to be allowed on the renewal notes on account of the tightening in the money market, although the interest rates on the long-term loans remained fixed or could not be increased to the same extent. The result of this situation was not only a narrowing of their profit margin, but also in a few instances involved some of these institutions in an embarrassing predicament, in the sense that they experienced great difficulties in obtaining the funds necessary for the payment of the maturing notes. For such contingencies the Federal Loan Institution had been established and, as outlined previously, it acted as a very welcome reserve or rediscount agency, fully equipped to cope with the emergency. While none of the banks was compelled to liquidate as a result of these developments, the comparative illiquidity of some of the institutions involved was serious enough to focus public attention on the unfortunate practice of these banks in financing credits of a long-term character on a short-term basis. There is no doubt that the war uncovered in this respect a weak spot in the Swiss banking structure. Ever since, efforts have been made to provide for legislation creating a long-term credit instrument of the type of the German mortgage bonds or to some extent, of the Federal Land

Bank bonds used in the United States. Appropriate legislation has been taken under consideration.

THE TRUST BANKS. It has been pointed out that the group of banks affected by the rising price of money included also the trust banks. These banks not only met with the same great difficulties in the renewal of their maturing notes and debentures, but suffered also very severely from the decline of the security prices which occurred after the war. Taking 1914 as 100, the average of a number of stock prices reached in 1921 a low of 38.3 [22] and of bond prices in 1920 of 63.7. Since a large percentage of the holdings of these trust banks consisted of foreign currency securities, they suffered still heavier losses as a result of the depreciation of the respective currencies. Several of these banks had to proceed to reorganizations by writing down their stock or by converting debentures into preferred stock. It seems likely that many of these losses could have been avoided if these investment trusts or banks had shown a better or wider diversification in their investments, and had been farsighted enough to foresee the currency debacle or had had the courage of taking the small initial losses. However, it is easy to criticize at this time; looking forward in those days was, no doubt, a different proposition. The fact remains, nevertheless, that large losses occurred and while they cannot be traced to an incomplete or faulty banking structure, their occurrence seems to confirm the view that expert management is the most important factor in the investment trust business. In view of the recent mushroom-like growth of the investment trusts in the United States, these experiences of the Swiss trust banks during and after the World War should prove very helpful.

ECONOMIC CONDITIONS IN 1920–1921. Post-war banking in Switzerland, as in most other neutral countries, was bent upon the reëstablishment of normal trade relations and was under the influence of two distinct developments: first of the deflation process and second of the currency chaos in continental Europe. In 1920 and 1921, both Swiss exports and imports dropped in value by over 50%. Money remained scarce. Many of the exporters were compelled to sell their foreign currency holdings at heavy losses as a result of the decline in the exchanges. Merchandise

[22] Publications of Swiss Bank Corporation.

stocks accumulated. Prices began to drop and business passed through a deflation crisis. Many of the bank loans became frozen. Some of these accounts had to be carried by the banks on their books for years, but were gradually liquidated as conditions improved again. The resulting illiquidity of the banks and the shrinkage in deposits as a result of the drop in the price level were fortunately more than offset by the steadily growing inflow of foreign deposits from the neighboring countries which possessed inflated currencies. The Swiss markets, like the Dutch and Scandinavian markets, besides New York and London, became financial centers for German, Central European and Balkan and later also for French, Belgian and Italian financial transactions, which ceased with the stabilization of the currencies involved. In the meantime, however, these transfers of funds, as pointed out previously, brought remunerative business to the banks and permitted them to keep liquid. It would be difficult to estimate their amount, but they no doubt were very large and permitted the banks to overcome the deflation difficulties with more ease than would have been possible otherwise. One of the banks, incidentally the oldest Swiss bank, however, had to undergo a reorganization owing to the losses suffered on its large holdings of German mortgage bonds. (Only a small part of these mortgages contained gold clauses.)

The significance of these post-war developments for the large Swiss banks was very great. Although business was more or less at a standstill, the banks remained very active as a result of the large amount of international transactions which they handled. The central location made it easy for them to do a large amount of exchange arbitrage and for the same reason they were chosen by the business circles of Central Europe to act as their fiscal and clearing agents. They thus strengthened their international position greatly, and were able to hold many of these connections even after the various currencies had been stabilized.

Participation of Swiss Banks in Financial Rehabilitation of Europe. The continuous inflow of funds from abroad and the standstill of domestic business resulted, naturally, in an abundance of money in Switzerland which found its expression in extremely low money rates, maintained throughout the last four or five years. This abundance of money and also of capital per-

mitted the banks to participate on a comparatively large scale in the financial reconstruction of Europe. They took a substantial interest in the various stabilization loans which were issued, such as the Austrian, Hungarian, Czechoslovakian, German, Polish, Italian and Greek loans, and assisted both Belgium and France directly in their stabilization by granting them comparatively large credits. They also participated directly in a great many of the European issues floated in New York in recent years, and granted directly numerous loans themselves to foreign public and private borrowers. These foreign lending activities of the banks, which were in line with pre-war practices, were of course remunerative and added greatly to their prestige abroad. Whether they will be continued depends entirely on the position of the money and capital markets which may be expected to tighten at some future date. That the Swiss markets have been able to absorb in recent years as large an amount of foreign issues as they did, is by itself a splendid indication of their strength and absorptive power, especially if we consider that Switzerland, unlike the Netherlands for instance, does not have the benefit of colonial resources. This large absorption which, of course, may partly be accounted for by sales to foreign investors (French, Belgian, German, etc.), would also point towards the existence of efficient sales methods and of an excellent distributive machinery.

For some years after the war a discount market was existing to a certain extent in Zurich. However, it never reached great importance and it may not be expected that Zurich will follow Amsterdam in aiming at the establishment of such a market.

Liquidity of Banks. Were the Swiss banks liquid during and immediately after the war? If we were to answer this question in a few words we would say: "Yes, they were," but we would add that, although according to their statements they showed a higher liquidity than before the war, intrinsically, they were less liquid, largely because of the war developments and of the governmental interference with all free trade and all free financial operations. But after all, liquidity, like everything else in human terminology, is a relative term, and considered in the light of general liquidity of all the European banks of that period, the Swiss banks were no doubt among the most liquid institu-

tions on the Continent. Keeping this in mind, we now may shortly examine the bearing which the various developments, reviewed previously, had on the intrinsic position of the banks.

The outbreak of the war found many of the small banks with very low cash reserves. This situation necessitated excessively heavy and too rapid drawings through rediscounts and borrowings, upon the resources of the central bank and were one of the reasons why the latter had to establish stringent limitations on payments mentioned under a previous heading. Moreover, the banks were unable to cash their large foreign bill holdings on account of moratoriums that had been established in most of the European countries. Thus one of the pre-war banking theories which had always considered foreign bill holdings as one of the most liquid banking assets failed to work out under the then existing circumstances. The banks were equally unable to sell large blocks of securities because of the general closing of the stock exchanges, with the exception of the one in Geneva. These developments, no doubt, made it hard for them to cope with the panic of July and August 1914, as described under a previous heading, but they impressed the banks with the necessity of increasing their liquidity. The comparative abundance of money in the years that followed, with the resulting increase of short-term deposits, made things for the bank in this respect much easier; the seven largest commercial banks improved their liquid holdings (cash and balances with central and other banks, portfolio, call loans) from 28.13% of their total resources in 1913 to 41.43% in 1917.

Quality of Balance Sheet Items. The question arises at once, whether the quality or character of the various balance-sheet items in 1917 and later, was the same as in 1913. On the credit side, the short-term deposits increased greatly since 1914, while the long-term deposits (debentures) remained stationary or showed only a slight increase. Before the war, the debentures issued by the seven largest commercial banks were in excess of their total deposits in current accounts, but by 1918 the latter were more than double the amount of the former. This important change in the character of the deposits necessitated, of course, a higher ratio of liquidity. On the asset side, the loans and the balances with correspondents expanded very rapidly, the latter

being in 1918 more than six times as large as in 1913. The character of these expansions (credits to finance the war needs and foreign exchange balances left abroad) has already been explained and there is no doubt that, although a larger percentage of the loans were secured than before the war, they were on the whole much less liquid than in pre-war years and, as far as the foreign exchange balances are concerned, could only have been repatriated with losses. The bill holdings of the banks showed an entirely different composition than the pre-war portfolios. The prime trade paper that entered and left the portfolio with high velocity became scarce; in its stead government finance paper gradually began to fill the portfolios, such as treasury bills or notes of the Federal and the state governments and of the Federal Railroad. The average amount of the bills increased steadily, and their average maturity actually trebled compared with the average pre-war maturity of the holdings of the central bank. In addition, the portfolios contained large amounts of municipal treasury notes, obligations of coöperative societies and the discount paper which resulted from the credits granted to the belligerents, as explained under a preceding heading. The portfolios were undoubtedly much less liquid, if not less secure, than before the war. The investments of the banks, especially of the trust banks, were seriously affected by the price declines in the bond and stock markets and the depreciation of the foreign exchanges.[23] In some instances the book losses became so heavy that the banks involved hesitated to bring their holdings down to market values. They even appealed to the Federal Government on the subject, which finally authorized them in December, 1919, to list their exchange losses as an asset item to be written off over a period of years, while only limited dividends could be paid or none at all.[24]

From this short sketch of the most important asset items one cannot help gathering the impression that the banks intrinsically

[23] The bond index of the Swiss Bank Corporation as given in the Annual Review for 1920–21 (page 104), was in 1913, 90.57 and in 1920, 59.07. The stock index was in 1913, 183.00 and in 1920, 76.27.

[24] The large banks, with one minor exception, never availed themselves of the right given in the Decree of December, 1919. However, the losses thus carried by 22 smaller banks up to 1926 amounted to about $100,000,000. At the end of 1926 they were practically fully written off.

were less liquid than in pre-war years, especially if the large contingent liabilities (guarantees to importers, etc.) were taken into consideration. They probably were not less secure than before the war, but simply less liquid, being victims of the artificial war economy which also affected other parts of the economic structure.

Reserves Accumulated. Fortunately, the banks made large profits during the war, acted very conservatively in distributing them and accumulated large reserves, mostly in hidden form for which no figures are available. These reserves made it possible for most of them to write off the large losses which they suffered after 1919 when the reaction came. These losses were very large for some of the banks, especially for some of the mortgage banks which were holding mark mortgages and for the trust banks and, as previously outlined, a few of these institutions had to be reorganized.[25] The large banks did not hesitate to take their losses at once, back in 1920, and made great efforts to reëstablish their pre-war liquidity. The rapid and steady inflow of foreign deposits which took place after the war greatly facilitated their endeavors in this connection. This steady flow of deposits proved that there was no doubt existing abroad as to the high liquidity and solvency of the Swiss banks.

The abolition of the many emergency measures, the liquidation of the war credits, and the writing off of the losses, permitted them to return rapidly to pre-war liquidity, and in recent years they have consolidated and enlarged their international position, arising thus from the war and post-war period intrinsically, as well as extrinsically, much stronger.

The rapid expansion of the large banks during the war affected their capital structure basically. All of them increased their capital stock during and after the war, some of them repeatedly and especially in 1926 and 1927 very large increases have taken place improving thus somewhat the ratio of 5 to 1 for deposits to capital investment which existed at the beginning of 1921 for the large commercial banks.

[25] In 1921, for instance, the published losses and "write-offs" of the eight big banks included in the statistics of the Swiss National Bank amounted to 14.9% of the gross profits, as against 6.1% in 1913 and 4.97% in 1926. All the banks, except one, paid their regular dividend throughout the whole period.

CONCLUSIONS

The banking system forms that organism in the body economic whose task it is to segregate and supply the credit needed. Whether this is done in one way or another does not matter, provided the system efficiently supplies all the credit that is required. In its ability to do this, rests the test of its efficiency. This means that banking systems and banking methods may vary from country to country, since different economic structures, different habits and customs, demand different types and methods of banking, and it may be assumed that, the more the banking system adapts itself to these conditions, the better will it be able to satisfy the various needs.

To what extent now is the Swiss banking system serving the needs of the Swiss business community? Is it operating efficiently and furnishing the maximum amount of credit needed? Does it thus stand the test of the ideal system? To answer these questions, it will be necessary to review in a few words the system as a whole.

Switzerland, a confederation of different historical units, rich in local traditions and customs, with intensive agriculture on one hand and extensive industrial activity on the other, both carried on a comparatively large scale by a great number of small enterprises, demands a strongly diversified credit system that adapts itself to local conditions. The existing structure, indeed, presents the picture of such a system. It consists of two major groups of banks, viz., the eight "big" commercial banks and the cantonal banks. The big commercial banks attend to the needs of the large commercial and industrial enterprises, and although individually centralized, they have succeeded in having their branch offices adapted to local conditions. The existence of as many as eight large and many independent small commercial banks makes a monopoly of the "big" banks impossible and insures cheap terms to the borrowers and a sufficient supply of credit. The other group, the cantonal banks (as state-owned institutions) handle largely land credits and the smaller domestic commercial business, but they possess no monopoly in this field, since they have to compete with a large number of independent

mortgage, savings and coöperative banks which also attend to the needs of the small borrowers. The branches and deposit agencies developed by many of the cantonal banks warrant sufficient contacts with local customs and needs. Investment banking is taken care of by the " big " commercial banks, by the private banks and by the investment trusts, while the administration of trusts and estates is handled, to a larger or smaller extent, by all the banks. This indicates and confirms the idea that the Swiss banks on the whole are little specialized and that the system is supple. The country's monetary circulation is confined to a central institution which acts as a bankers' bank, but does not possess an especially strong control over the credit supply. This fact, however, does not impair its reserve or central bank capacities or functions.

If now again we repeat the question as to whether or not the Swiss banking system is well developed, the answer will have to be in the affirmative. Credit is developed to a high degree in Switzerland and the banks have well adapted themselves to the various needs. It is true that the Swiss system and some of its practices differ somewhat from those of other countries (to mention only the practice of issuing debentures) but these differences are not fundamental, and exist merely as historical adaptations to the developments in business and industry. The confederate character of the political structure in Switzerland (like that in the United States) created a strong individualism which is also reflected in banking. The variety of economic activity and the absence of legislative limitations caused the banks to diversify their services. Thus Swiss banking is not specialized like British or French banking and does not know the French centralization. On the whole the Swiss banking system is therefore, while not ideal and in many respects badly in need of improvements, no doubt well developed and ranks among the highly efficient banking systems in the world.

The system withstood the test of the war quite well, but suffered from two shortcomings which need adjustment. In the first place, the war made it clear that the practice of financing long-term land loans through the issuance of short-term debentures had to be changed. Appropriate legislation creating a long-term credit instrument (special mortgage bond) was therefore initiated

and is now pending in Parliament. In the second place, the war experiences confirmed the fact that a wide and large diversification in loans and investments are an imperative necessity for sound and conservative banking operation. A number of Swiss banks suffered heavy losses from an overextension of loans or excessive investments in neighboring countries with depreciated currencies. A more extended diversification, somewhat in line with the conservative policies of the British banks and investors, might have prevented many of these losses. The banks, and especially the investment trusts, undoubtedly have learned a lesson during the war and it may be hoped that they will strive to obtain a wider diversification in the future.

With regard to the administrative side of Swiss banking, it may be said that one of the best assets of the banks is their highly skilled staffs, both managing and clerical, consisting to a large extent of people who for years have lived and studied in foreign countries, and are therefore highly qualified to handle international banking business. The internal organization of most of the large banks is up to date and efficient, the same mechanical devices being used as in the United States. Since there is no legal necessity, most of the Swiss banks publish their statements but once a year. It is highly unfortunate that this practice has not been abandoned as yet by the large banks in favor of a more frequent, periodical and detailed publication which certainly would increase their prestige.

The war has strengthened the international position of the Swiss banks greatly. The neutral and central position of the country and its sound currency gave them a privileged position for the handling of financial transactions on the Continent, both during and after the war and they availed themselves of the opportunity offered. They were, no doubt, heavily engaged at the beginning of the post-war period, but what other banks on the Continent were not in the same or a worse position at that time? The fact is that they absorbed all losses without difficulty, recovered quickly, and arose from the war and the post-war period stronger than ever. In recent years they have been doing a tremendous amount of international financing, considering the proportionately small absorptive investment power of Switzerland, and it may, therefore, be assumed that again, as during so many

times in the last decade, they have been acting and serving as highly valued intermediaries in the continental migration or transmission of capital from country to country. That the rapidly progressing stabilization and normalization in Europe will tend to limit their international functions somewhat, seems natural. Switzerland, unlike Holland for instance, has no command over colonial resources which provide for a steady capital supply. The activities of her banks will therefore in the future be narrowed to the demands and needs of Swiss trade, industry and agriculture and to such business as may be intrusted to them from the outside on account of such factors as a central or a neutral position, a well-trained management and personnel and comparatively low taxation. The indications are that this business will remain large or even increase in the years to come.

CHAPTER XVII

THE BANKING SYSTEM OF THE UNITED KINGDOM

BY

H. E. Butson [1]

THE GROWTH OF BANKING IN THE UNITED KINGDOM

The Goldsmiths. The foundations of the British banking system were laid in the latter half of the 17th century by the goldsmiths of the City of London. In the early part of the century the merchants had been accustomed to deposit their surplus coin and bullion in the Tower of London for safe custody under Government protection — an arrangement which was apparently satisfactory until in 1640 the King, Charles I, unable by any less drastic method of public finance to raise funds to pay his disheartened army, seized £130,000 of the merchants' gold deposited in the Tower and used it to cover his more pressing needs. This depredation naturally prompted the mercantile community to seek other and safer arrangements for the custody of their treasure. They tried keeping it themselves, but the dishonesty of their cashiers soon convinced them that this method was little better than Government protection, and so they began to entrust it to the goldsmiths, whose integrity was universally recognized. In this way they inaugurated a system which in its main features anticipated the functions of modern English banking.

The goldsmiths, already familiar with the bullion trade, commenced their banking activities by receiving money on deposit and lending the greater part of the lodgments to people who required accommodation. Receipts were given for sums deposited, and these soon came into circulation in place of the gold they represented. These gold receipts, or goldsmiths' notes, were the earliest form of English bank note. A little later the de-

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positors acquired the habit of drawing checks on the goldsmiths who held their funds. One of these checks, believed to be the oldest in existence, is still preserved in the library of the Institute of Bankers in London. It is dated August 14, 1675, and bears all the characteristics of the present-day check, including a form of receipt on the back, signed by the payee, taking the place of the modern indorsement. In this way, by gradual steps, the goldsmiths, besides acting as bullion dealers, began to engage in all those operations which are still regarded as the chief functions of a bank — they conducted current accounts, received deposits, granted loans, discounted bills of exchange, and even dealt in foreign currencies. In the early stages, no interest was paid on deposits, but the high rates which could be obtained for loans ultimately led the goldsmiths to encourage more deposits by offering attractive rates of interest.

Short-Lived Success. So long as they avoided any business relationship with the Government, the goldsmiths seem to have prospered; but their success was short-lived, and just as the merchants in 1640 had paid dearly for the confidence they placed in the Government, so were the goldsmiths in their turn destined to be ruined by confidence similarly misplaced.

When Charles II came to the throne in 1660, the financial position was little better than that bequeathed by Charles I eleven years previously. Finding the revenue inadequate for his needs, the "Merry Monarch" had recourse to the goldsmiths, who granted him loans in anticipation of taxes which had been voted by Parliament, the revenue being assigned to the goldsmiths as security. This expedient had been resorted to occasionally by Cromwell during the Protectorate, but in the reign of Charles II the goldsmiths were called upon to advance much larger sums. This they were not unwilling to do as they were able to exact an increasing rate of interest — eventually as much as 12 per cent. per annum. The security, however, was uncertain since the goldsmiths had no control over the taxes, and with the revenues assigned growing more and more distant, the goldsmiths began to cease making further advances.

"Stop of the Exchequer." In 1672 the King, urgently requiring money for a war against Holland, took the serious step of stopping all payments from the Exchequer. The Government

having thus suspended payment to the goldsmiths, the latter in turn had no alternative but to suspend payment to the merchants whose deposits they held, and widespread ruin resulted. The amount owed by the Government to the goldsmiths at the time of the suspension was £1,300,000, and although payments on account of interest were made from time to time, the capital was never repaid, being eventually merged in the National Debt.

The "Stop of the Exchequer" dealt a severe blow to the activities of the goldsmiths as bankers. The wealthiest of them — by far the greater number — returned gradually to their original trade. A few of the stronger and more fortunate were able to continue as bankers, and came to be known as such, although they did not for some time abandon their business as goldsmiths proper.

Early History of the Bank of England. The shock to the goldsmiths' credit, combined with increasing unpopularity on account of the exorbitant terms which they exacted from their customers, directed attention to the desirability of forming a banking institution which by virtue of its size and public character should be in a position to give the mercantile community greater security and more reasonable terms than the goldsmiths could offer. Many projects were brought forward for the formation of a bank which would hasten the growth of English commerce by providing credit at a low rate of interest and a stable bank note currency. The scheme ultimately adopted was that of William Paterson, a Scotsman, and the development in English banking which he originated was again closely connected with the financial difficulties of the Exchequer.

Paterson seems to have realized that his idea of forming a bank was most likely to receive parliamentary sanction if it provided for a loan to the Government. In 1694, he was able to carry out his project. William III's Government being in need of funds, Paterson suggested that subscriptions should be invited for a sum of £1,200,000 on the understanding that the subscribers were to be formed into a corporation called "The Governor and Company of the Bank of England," and that the £1,200,000, which would form the capital of the Company, would be lent permanently to the Government. Interest was to be paid on the

loan at the rate of £100,000 a year, and the Company was to have the right of issuing notes to the amount of its capital.

THE TONNAGE ACT. The suggestion was adopted, and legal effect was given to the scheme by an Act of Parliament which also introduced certain taxes unconnected with the Bank, and which was called the "Tonnage Act" from the inclusion among its provisions of a tax on the "Tunnages of Ships." The required capital was readily subscribed and in due course the Company was incorporated. In spite of the opposition of its political opponents, the new bank was a success, so much so that it soon became clear that although the Government had reserved power to withdraw the Bank's Charter after twelve years, neither the Government nor the nation was likely to dispense with an institution which was to render such valuable services to both.

The business of the Bank consisted of the issue of notes, the receipt of deposits on which interest was paid, and the granting of loans on the security of real estate. It appears that no steps were taken to secure the convertibility of the notes, an omission which increased the difficulties of meeting the runs made on the Bank from time to time when polititical conditions caused a temporary weakening of public confidence.

THE BANK RESTRICTION ACT. During the first hundred years of the Bank's existence, the successive crises, both political and economic, in the nation's history were faithfully reflected in the history of its Bank, which was on the whole equal to the demands made upon it. Little difficulty was experienced in obtaining renewals of the Charter as occasion arose, although each renewal involved a further loan to the Government, which was generally arranged by an addition to the Bank's capital. Progress continued to be made until, towards the end of the 18th century, the Bank proved unequal to coping with the difficult position created by the French Revolution and entered upon the least creditable phase in its history — the period of the Bank Restriction Act, which was in force for 22 years.

The difficulties leading to the suspension of cash payments seem to have arisen partly from the unsound financial policy of the Government and partly from mismanagement of its note issue by the Bank. In order to raise funds for the war with

France which followed the Revolution, the Prime Minister borrowed from the Bank on the security of Treasury bills such large sums that the liquidity of the Bank's position was seriously endangered. These loans were used to provide subsidies to England's allies and to pay the expenses of the British troops abroad. Both operations tended to turn the exchanges against England and involved a heavy export of specie, while the Bank, instead of attempting to counteract this tendency by reducing its note issue and so lowering prices, unfortunately chose such an inopportune moment to increase the issue by adding £5 notes to those already in circulation, £10 having previously been the lowest denomination. The drain of gold was in this way accentuated, and the Bank's reserve dwindled. In February, 1797, the Bank's troubles culminated in a run on the country banks, which was precipitated by fears of a French invasion. The country banks, to meet the run, withdrew more gold from the Bank of England, the monetary stringency being increased by the fact that the Bank had now begun to contract the note issue.

The position of the Bank thus became so serious that the Directors had to apply to the Prime Minister for assistance. The result was the passing of the Bank Restriction Act of 1797, by which the Bank was forbidden to make any payments in specie except to the Army and Navy, or by order of the Privy Council. The use of Bank notes was at the same time encouraged by making them valid for the payment of taxes, although they were not given full legal tender quality.

For some years after the passing of the Act, the policy of the Bank was wisely directed. As Bank notes were now inconvertible, there was naturally a tendency towards inflation, as a result of which Bank notes fell to a discount compared with gold. This, however, did not reach large proportions until 1809. In that year, a great change came over the situation. The restriction of trade and the scarcity of commodities arising from the war with France brought about a speculative mania which the Bank, abandoning its former conservative policy, encouraged by granting loans in excess of the requirements of legitimate trade and increasing its note issue to an unprecedented extent. The example of the Bank of England was followed by the country banks, and as a natural consequence of the inflation of currency

and credit, the discount on Bank notes increased rapidly and the exchanges turned against England.

THE BULLION COMMITTEE. In view of the alarm caused by these symptoms, a committee was appointed by Parliament to inquire into the connection between the increase of the note issue on the one hand, and the price of gold and the adverse movement of the exchanges on the other. This was the celebrated Bullion Committee,[2] which by defining authoritatively for the first time in England the elementary principles of sound monetary policy did much to remove the almost universal confusion of thought which then prevailed with regard to these matters. The Committee reported that the high price of bullion and the adverse exchanges were due to the excessive note issues arising from the suspension of cash payments, and that the only remedy was a return to cash payments (i.e., convertibility of the notes) whereby the issues of the Bank of England would again be brought within proper limits. The report was presented in 1810, but Parliament was not at once convinced of the soundness of its conclusions, and it was only after nine more years of inconvertible paper money, during which there was a further heavy depreciation of sterling, that the elements of monetary science as laid down by the Committee were accepted. In 1819 an Act was passed which provided for the repeal of the Bank Restriction Act by gradual steps. Shortly afterwards, gold was again in circulation, and Bank notes returned to their par value.

BANKING IN THE PROVINCES. The expansion of trade which followed the resumption of cash payments began to direct attention to the unsatisfactory position of banking in the provinces. By an Act of 1742, the right of issuing notes in England was restricted to the Bank of England, and to partnerships of less than six persons — an anomalous arrangement, since the smaller banks were generally the less stable ones. This regulation, however, did not entirely preclude the establishment of banking partnerships of more than six persons. It applied only to the issue of notes, and it was soon realized that deposit banking could profitably be conducted without the right of issue, the check taking the place of the note. Nevertheless, the position in the provinces

[2] The report of the Committee is reprinted in Cannan's "The Paper Pound of 1797–1821." London — P. S. King & Son, 1919.

remained unsatisfactory as the Bank of England could not compensate for the absence of powerful note-issuing institutions by establishing branches. The crisis of 1825 revealed the weakness of the system, and resulted in the Act of 1826 by which the establishment of joint stock banks with any number of partners and with the right of issuing notes was made legal anywhere outside a radius of 65 miles from London. By the same Act, the Bank of England was empowered to establish branches.

After the passing of this Act, there remained some doubt as to the legality of the establishment within 65 miles from London of joint stock banks with more than six partners, but without the right of note issue. All doubt on this point was removed in 1833, when, in an Act renewing the Bank's Charter and making Bank of England notes legal tender, the establishment of such banks was specifically declared to be legal. Shortly afterwards, the earliest of the London joint stock banks were founded.

Crisis of 1837–40. In the years from 1837 to 1840, the financial system passed through another severe crisis which was to prove the turning-point in its history. The experience gained during those years led to the passing of the Bank Charter Act of 1844, which may be regarded as the opening of the modern era of British banking. The principles then introduced have stood the test of time, and remain, substantially in their original form, as the basis of our present-day banking system. The Bank Charter Act is therefore a suitable starting-point for an outline of the modern organization of the Bank of England, and the position it now occupies in British finance.

THE BANK OF ENGLAND OF TO-DAY

Administration. As will have been gathered from the foregoing pages, the Bank of England is a joint stock company incorporated by charter. It is not a national bank in the sense in which that description is applied to the central banks of certain other countries where the Government exercises direct control, but it is national inasmuch as it bears the responsibilities in connection with the money market usually associated with a state bank besides undertaking the management of the note issue and

the National Debt. Apart from the regulations as to the issue of notes, and the obligation to publish accounts in the form prescribed by the Act of 1844, the Bank is, in theory, free to conduct its business as it pleases. In practice, however, it recognizes the duties which arise from its peculiar position as the corner stone of the British financial structure, and the directors in framing their policy always give primary consideration to the public interest rather than the profit of the stockholders.

Management of Bank. The management of the Bank is in the hands of a court of 24 directors, a governor and a deputy governor, all eminent bankers and business men in the City. In so far, however, as they are bankers, they are drawn from the private banking and financial houses, it being an unwritten rule that no director of any of the large joint stock banks shall be also a director of the Bank of England, since he might by virtue of his position acquire a knowledge of the affairs of other banks which would give his own bank an unfair advantage over its competitors. A slight relaxation of this rule was made recently when a director of one of the British colonial banks was elected to the Board of the Bank of England.

The Governor and Deputy Governor normally hold office for a period of two years, but this practice has occasionally been departed from when abnormal circumstances have rendered it desirable. The most notable exception is the term of office of the present Governor, who has now held the position for seven years, giving a continuity of policy which has been of great value in the difficult conditions of the post-war period. The system of management of the Bank has in the past frequently been criticized on the ground that insufficient provision was made for continuity of policy, and it was doubtless to meet this objection that, in 1918, the permanent office of Comptroller was created. The Comptroller is now the chief administrative official, and serves as a link between the directorate and the executive officers.

Position of Stockholders. The stockholders themselves have virtually no voice in the management of the institution. They meet four times a year as ordained by the Bank Charter, but the proceedings are purely formal, the recommendations of the directors being invariably adopted. No balance sheet is issued apart from the weekly return prescribed by the Bank

Charter Act, and no further information regarding the Bank's business is ever divulged.

It should be added that the Bank has ten branches: two in London, and eight in the chief provincial towns.

THE BANK CHARTER ACT. To revert to the Act of 1844 — its chief provisions were those governing the note issue, and the publication of accounts. The effect briefly was that the right of note issue in England was confined to banks which possessed and exercised this privilege before 1844. Subject to this exception, the Bank of England was given the exclusive right of note issue. The Bank was to be divided into two departments — the Issue Department and the Banking Department. A limit was fixed for the fiduciary issue, and notes issued above this limit were to be fully covered by gold. The Bank was also compelled to buy all gold offered to it at the fixed price of £3. 17. 9. per ounce troy, 11/12ths fine, and to sell at £3. 17. 10½ per ounce. Finally, it was to publish every week a return in the form prescribed by the Act.

THE BANK'S WEEKLY RETURN. The weekly return is naturally an object of great interest to the money market since it is the key to the position of the Bank and therefore one of the chief indications of the probable future course of money rates. It is published every Thursday morning after the weekly meeting of the directors. The following is a copy of the return published on Thursday the 27th of May, 1926.

BANK OF ENGLAND

An Account pursuant to the Act 7 and 8 Vict. Cap. 32 for the week ending [3] on Wednesday the 26th May, 1926.

ISSUE DEPARTMENT

	£		£
Notes Issued	167,576,815	Government Debt	11,015,100
		Other Securities	8,734,900
		Gold Coin & Bullion ...	147,826,815
		Silver Bullion	——
	167,576,815		167,576,815

Dated the 27th May, 1926.

C. P. Mahon,
Chief Cashier.

[3] The words "for the week ending" suggest that the figures are the daily averages for the week. This is not the case, and a more correct description would omit these words since the return shows the position only as at the close of business each Wednesday, and not over the whole week.

BANKING DEPARTMENT

	£		£
Proprietors' Capital ...	14,553,000	Government Securities .	41,035,328
Rest	3,208,423	Other Securities	71,816,648
Public Deposits (including Exchequer, Savings Banks, Commissioners of National Debt and Dividend Accounts)	20,220,299	Notes	26,944,885
Other Deposits	103,041,828	Gold and Silver Coin ..	1,180,576
7-Day and Other Bills ..	3,887		
	141,027,437		141,027,437

Dated the 27th May, 1926.

C. P. Mahon,
Chief Cashier.

The Issue Department. The figure shown against "Notes Issued" is the total amount of Bank notes outstanding on the date of the return. The notes are issued for amounts of £5, and certain multiples of £5, and are convertible on demand at the Bank into gold bullion in the form of bars containing approximately 400 ounces of fine gold. Notes which are paid in to the Issue Department are never reissued — a fact which makes the Bank of England issue an expensive one to maintain. The notes are legal tender in England (except by the Bank itself) for all amounts above £5.

The right hand side of the account of the Issue Department shows the assets held against the note issue. It will be seen that with the exception of £19,750,000 the whole of the issue is covered by gold coin and bullion. The amount of the fiduciary portion of the issue was arrived at in the following way:

When the Bank Charter Act was drawn up, it was thought that the maximum portion of the issue which was never likely at any time to be presented for payment was £14,000,000. The Bank was therefore authorized by the Act to issue notes to this amount covered by securities instead of gold. Of these securities the Government debt of £11,015,100 to the Bank was to form part. It was also provided that if any of the country banks which retained the right of issue under the Act should thereafter relinquish the right, either by ceasing to exist or by amalgamating with other banks within 65 miles of London, the Bank of Eng-

land should have the right of issuing notes against securities to the amount of two-thirds of such lapsed issues. The present figure of £19,750,000 for the fiduciary issue represents the original £14,000,000 plus further amounts issued from time to time in place of the lapsed issues of other banks. The Bank of England is now the only note-issuing bank in England and Wales, all the other banks which retained the right of issue under the Act of 1844 having since lost it, chiefly through the process of amalgamation.

It will be noticed that a space is provided in the return for silver bullion. Under the Act, silver bullion may be held to the extent of one quarter of the gold held in the Issue Department, but in practice this right is not exercised. It would be of little use if it were, since the silver would have to be realized before it could be used to meet cash demands.

The Banking Department. Turning to the account of the Banking Department, we find as the first item on the liabilities side the "Proprietors' Capital." This is in the form of stock, all of the same class and carrying the same rights. There is no fixed rate of dividend, but it is actually seldom varied. It has been at the rate of 12 per cent per annum since 1923 and the stock is priced on the Stock Exchange in accordance with its yield on the same basis as British Government securities. The stock is fully paid up, and carries no liability. No holder of less than £500 stock has power to vote at a general court.

The "Rest" represents the Bank's undivided profit. It is never allowed to fall below £3,000,000, so that £3,000,000 of it can be regarded as the Bank's Reserve Fund, and any sum above this figure as the balance of the Profit and Loss Account.

"Public Deposits" comprise the balances of the various accounts which the Government keeps with the Bank. It may here be noted that the whole of the Government's banking business is entrusted to the Bank of England with the exception of those current accounts which for the sake of convenience are kept by certain of the Government's agents, such as postmasters and tax collectors, with banks in the towns in which they operate.

"Other Deposits" are an item of very great importance in the money market, for reasons which will appear when we come to deal with the Bank's reserve. Under this heading are included the deposits of all the Bank's customers with the exception of

the Government. The Bank of England is sometimes called the "Bankers' Bank" because all the English banks of any importance keep accounts with the central institution. The balances of these accounts, on which no interest is paid, are included in Other Deposits and must necessarily form a large proportion of them. Until 1877, it was the Bank's custom to show separately the totals of the bankers' deposits and the deposits of other customers, and in view of the importance of the bankers' balances as an index to the strength of the banking position, it is thought by many people that it would be an advantage if this practice were revived.

The item "7-Day and Other Bills" is of little importance. It refers to the "post-bill," a type of bill introduced by the Bank in days when facilities for remitting money were less developed than they are now. These bills are drawn by the Bank on any of its branches, payable to the order of a specified person seven days after date, and issued to persons desiring to remit against payment in cash, the object being to give the sender an opportunity of notifying the Bank if the bill should come into wrong hands in transit. This method of remittance is becoming obsolete, having been superseded by the check, and by the postal orders and money orders issued by the Post Office.

On the assets side of the Banking Department account we come first to "Government Securities." This covers all the securities of the British Government held by the Banking Department. They may be in the form partly of long-dated and marketable Government securities ordinarily so called, and partly of Treasury Bills, and in part may consist of the Government's liability on temporary advances made to it by the Bank in anticipation of revenue. Such temporary accommodation is known as "Ways and Means" advances.

"Other Securities" are all the investments held by the Bank other than Government securities, and loans to private customers. The Bank does not publish any details of the composition of this item, but it covers all the credit facilities granted by the Bank to parties other than the Government, either by way of loan against security, or bills discounted.

The Reserve. The last two items — "Notes" (i.e., Bank of England Notes) and "Gold and Silver Coin" — are perhaps the

most significant of all, since together they comprise the total amount of cash held by the Bank against its banking liabilities. The aggregate is known as the Bank's " Reserve," which should be distinguished from the reserve fund referred to under the heading of " Rest." It must be borne in mind that the reserve of the Banking Department is purely a banking reserve, and is quite distinct from the gold held in the Issue Department as cover for the note issue. It will be noticed that by far the greater part of the banking reserve is held in the form of Bank notes. In view of the very large proportion of gold held in the Issue Department against the notes, these may be regarded as equal to gold, and when the Banking Department is required to pay out gold, the notes can readily be converted on application to the Issue Department.

Importance of Reserve. The great importance attached to the Bank of England's reserve arises partly from the fact that it represents the only considerable stock of gold — that is, internationally acceptable cash — held in England against the liabilities of the whole system, and partly from the nature of those liabilities. It is the custom of the English banks to hold themselves only sufficient cash to meet their normal day-to-day needs. They keep in their own coffers little more than a supply of till-money, and the remainder of their cash reserve consists of their balances at the Bank of England which, as we have seen, are included in the item " Other Deposits " in the Bank return. The Bank is thus their first line of defence, to which they have immediate recourse in the event of any abnormal demand for cash. For this reason, the ratio between the reserve and the deposit liabilities (i.e. Public Deposits and Other Deposits) is regarded as the vital feature of the Bank return, and the key to the banking position.

Effect of Cash Demand. How directly an unusual demand by the public for cash from any of the other banks is reflected in the position of the Bank of England will be seen if we consider what happens when such a demand is made. Let us suppose that a large sum of gold is required for export. The exporter applies to his bank for the gold, and as his bank probably holds no gold of its own, it is compelled to draw on its balance with the Bank of England. The exporter is given a check drawn by his own

bank on its account with the Bank of England which he cashes in the Banking Department, receiving Bank notes which in turn are converted into gold in the Issue Department. The effect of the operation in the Banking Department is to decrease both Other Deposits and the reserve by the same amount, and as Other Deposits are much larger than the reserve, it follows that the ratio of the reserve to liabilities is also decreased.

The effect will be the same if the cash withdrawn is borrowed from the Bank itself. There will then be an increase in Other Securities and a decrease in the reserve, while the liabilities side remains unaltered, the result being again a decrease in the ratio of the reserve to the liabilities. A similar decrease follows when the Bank makes a loan which, instead of being withdrawn in cash, is drawn on by check by the borrower to pay off an amount which he owes to someone else. The person who is repaid pays the check into his own bank, which in turn increases its balance with the Bank of England. The operation reflects itself in the Bank return as an increase in Other Securities, and an increase in Other Deposits, with no change in the reserve.

London as an International Financial Center. The smallness of the central reserve in comparison with the deposit liabilities of the banks as a whole is a striking feature of the British banking system, more especially in view of the exceptional position occupied by London in world finance. In the 18th and early 19th centuries Great Britain was the leader of the world in the development of industry and commerce, and as a natural corollary became also the pioneer country in the establishment of banking facilities. Not only was the internal banking system expanded and adapted to meet the growing needs of industry and commerce, but, with the extension of her foreign trade, Great Britain became the center also of a complicated network of international financial relationships.

While British leadership was thus growing, it became a tradition that London should always meet her obligations in gold on demand when required to do so. Other countries might, and did, in pre-war days, put obstacles in the way of the export of gold whenever such export was thought undesirable. The Bank of France, for instance, was accustomed to charge a small premium on gold withdrawn for export, and was also at liberty to pay

out silver in unlimited quantities to meet its liabilities, while in the case of Germany, any export which was thought to be inexpedient was discouraged by less direct means. In London, however, no restraint whatever was imposed. The result was that the bill on London was regarded abroad as the nearest approach to bullion itself, and came to fulfil the functions of an international currency so that to-day trade between foreign countries with which England has no direct concern is frequently financed by bills drawn on London.

In addition therefore to the responsibilities normally assumed by a national monetary center, London has to reckon with this mass of international bills which, while easily handled in normal times, may yet prove a heavy burden in times of crisis, for in such times London as drawee and acceptor must meet the bills in gold as and when they mature regardless of whether the parties ultimately liable are able to provide the necessary funds. So long as the financial machine is working smoothly the reserve is secure, but the slightest derangement of the mechanism suffices to cause a withdrawal of gold, and when this occurs, it is always at the expense of the central institution's reserve.

Such were the obligations arising from the position which London held before the war as the financial center of the world, and although England's predominance in this respect has since been somewhat lessened, it cannot be said that there has been any corresponding reduction in her financial responsibilities. On the contrary, she has now to reckon with the additional strain placed on the exchange by European countries which find it more convenient to remit to New York through London than directly, and to hold a large part of their cash reserves in the form of bills on and deposits in London.

All these liabilities depend in the last resource on the Bank of England reserve for their prompt liquidation. In such circumstances it is perhaps surprising to find that on only three occasions between 1844 and the outbreak of war in 1914 was the Bank of England put to any serious difficulty in meeting its obligations — during the crises of 1847, 1857, and 1866.

Financial Crises Since 1844. In 1847 the difficulty arose from exceptional exports of gold to pay for heavy imports of wheat following bad harvests, and from excessive speculation in

home railway securities. As a result of large advances to the market and withdrawals of gold, the Bank reserve fell to such a low figure that, in the absence of abnormal measures, the Bank would have been compelled to stop discounting. At this juncture, with important houses failing on all sides, and the market in a state of panic, the Government intervened, and relieved the pressure by informing the Bank that if notes were issued without gold backing in excess of the limit authorized by the Act of 1844, it would propose to Parliament a Bill of Indemnity in respect of the breach of the Act, it being stipulated that the minimum rate for loans and discounts should be 8 per cent. The Bank was thus at liberty to continue to advance to the market by adding to its fiduciary note issue. In the event, however, no infringement of the law proved to be necessary. The mere fact that money would be forthcoming if required was sufficient to relieve the tension, and currency which was being hoarded in anticipation of the complete exhaustion of the Bank's supply of cash was returned to the Bank, so that the reserve was soon replenished.

The precedent established in 1847 was followed on two subsequent occasions prior to 1914. The crisis of 1857 was due primarily to an over-expansion of credit at home accompanying the rapid extension of foreign trade. With the market already in an unsound condition, a financial crisis occurred in America, and its reactions caused numerous failures in London. The Bank found itself in the same position as in 1847, and similar measures were taken. On this occasion, the Bank actually had to avail itself of the authority to increase its fiduciary issue beyond the limit imposed by the Bank Charter Act, although the excess issue at no time reached £1,000,000, and the infringement of the Act lasted only 18 days.

In 1866, unsound financing of companies, and the growth of banking without sufficient attention to liquidity, prepared the way for a crash which was precipitated by the unexpected failure of a large and influential financial house, Overend, Gurney & Co., generally believed to be of unassailable strength. The Bank was once more authorized to infringe the Act of 1844, but as in 1847, no actual excess issue of notes proved to be necessary.

In 1890 the Bank of England was again faced by a very difficult position — this time as the result of widespread and exces-

sive speculation in foreign securities, which led to the unexpected failure of Baring Brothers, an issue house of high standing. By the prompt action of the Bank in promoting a guarantee fund to provide for Barings' liabilities, coupled with a high Bank rate and imports of gold, the situation was prevented from assuming the proportions of a serious monetary crisis, but disaster was only narrowly averted. Barings' liabilities were subsequently met in full, and in the form of a joint stock company under the name of Baring Brothers & Co. Limited the firm quickly regained its former prestige.

Elasticity of the Monetary System. The crises which we have outlined served to reveal what has been regarded by many people as the chief defect of the Bank Charter Act — the fact that it made no provision for elasticity in the note issue. The framers of the Act of course had a definite object in view when they made the Bank of England note so closely resemble a gold certificate. They believed that the greatest danger they had to guard against was a system under which the note issue was free to expand beyond the amount of gold available for monetary purposes, and that if this possibility were eliminated, crises would not occur. In other words, elasticity of currency was held to be incompatible with safe finance. Subsequent events have disproved this theory, but have not condemned the structure which was founded in 1844. England now enjoys both an elastic monetary system, which is an essential part of modern economic organization, and comparative immunity from crises, and these conditions have been attained by methods which can hardly have been foreseen by those responsible for the Bank Charter Act. Elasticity of the monetary system has been achieved by the perfection to which the use of the check as a credit instrument has been brought, the development of English banking in this direction having no doubt been stimulated by the rigidity imposed on the bank note issue by the Act of 1844. But this elasticity has not, since 1866, been accompanied by the recurrence of crises which was so much feared in 1844.

Skill in Management. Such a satisfactory development has been due in no small measure to the skill and prudence which have characterized the management of the Bank of England, and indeed of the banking system as a whole, since 1866, and the

system founded in 1844, under able administration has not only survived, but has proved well adapted to England's financial needs. The comparative immunity from crises which Pitt and his colleagues sought to secure by legislation alone has since been achieved by sound banking practice, while the development of the check system has enabled us to avoid that sacrifice of elasticity which was thought in 1844 to be inevitable.

The working of the money market as a whole, and the part played therein by the Bank of England, will be dealt with at a later stage. Before turning to these questions, we must give a brief description of the organization and functions of the other units in the market.

THE JOINT STOCK BANKS

A Century of Amalgamation. It has already been pointed out that the establishment of joint stock banks in London dates from 1833, before which year there had been some doubt as to the legality of joint stock banking within a radius of 65 miles from London. It was also stated that such banks, although their legality was then established, were not given the right of issuing notes, this privilege within the 65-mile radius of London being still confined to the Bank of England. The lines of development of joint stock banking in and around London were thus clearly defined from the outset — in the absence of power to issue notes, the banks, in building up funds with which to carry on business could rely only on their own capital and on the sums which would be deposited with them by their customers, a limitation which added to the difficulty of starting a bank, but was not a great handicap when once the bank was established. The inability of the banks to provide a paper currency was counteracted by the practice of allowing deposits to be drawn on by check.

First Joint Stock Bank. London was not slow to take advantage of the Act of 1833, and in the next year, the first joint stock bank in London was founded.[4] This was the London and Westminster Bank, which after having amalgamated with two

[4] The Bank of England is also strictly a joint stock bank, but in view of its exceptional position and functions, it is not usually classified as such.

other banks and absorbed many smaller ones still plays a prominent part in English banking as Westminster Bank Limited. Other joint stock banks followed both in London and the provinces. The London and Westminister Bank operated only in the London district, but other banks which were founded soon after at once spread their ramifications farther afield, opening branches in the country while keeping their head offices in London. There were at the same time many additions to the smaller local joint stock banks operating in the various provincial districts.

The advantages of joint stock banking, and the greater stability it afforded to customers as compared with private banking were quickly realized, and almost concurrently with the commencement of joint stock banking in London there set in the amalgamation movement which has continued down to the present day. The reasons for this tendency are not far to seek. In the first place, other things being equal, the strength of a banking institution increases with its size up to a point. Standing and reputation are of greater importance in banking than in any other business. A large bank is stronger than an equally well managed small bank both because it is sure to be better known and because with its larger resources it is better able to stand a run in any one of the various districts in which it operates.

Influence of Branches. There is the further advantage that a bank which has its branches well spread over the country is better fitted to serve industry and commerce not only in connection with remittance business, but also in mobilizing the country's financial resources. A bank operating in both agricultural and industrial districts is able to draw funds from regions where deposits are plentiful and employ them profitably in those parts where loans are most required. Similarly, a bank such as this, being connected with a large number of industries is better able to stand the effects of a period of depression in any one of them. Finally, there are the advantages to be obtained from economies in the working of a large institution.

In its earlier phases, the movement towards centralization took the form mainly of the absorption of the small local banks by the larger joint stock institutions. The process was necessarily progressive, because the larger the average size of banks all over the country became, the more handicapped were the smaller banks

in competing with the large ones. The banking business thus came gradually into the hands of a comparatively small number of joint stock banks, the largest being those with central offices in London and branches in various parts of the country. In 1900, there were in England and Wales 77 joint stock banks having 3,757 branches. By 1913 the corresponding figures had been changed to 43 banks with 5,797 branches,[5] showing that although the number of institutions was decreasing, there was at the same time a rapid expansion in the conveniences and facilities offered to the public.

The Amalgamations of the War Period. During the war, the movement took a new form, the familiar absorptions of the smaller banks by larger joint stock institutions being superseded by amalgamations between the great joint stock banks themselves, of which there had already been one or two examples. At the end of 1917, it was announced that two of the large joint stock banks with head offices in London had amalgamated, and this proved to be but the forerunner of a spectacular series of fusions which in their rapidity, and in the magnitude of the deposits which were affected, dwarfed anything which had gone before. During the following year, fifteen of the largest banks in the country became involved in the movement, and by the end of 1918 their number had been reduced to six.

The chief reason for the movement was apparently the anticipation that after the war, which appeared to be drawing to a close, the financial support which British industry would require in meeting the difficulties of the reconstruction period could be very much better provided by a few large and powerful banks than by a greater number of smaller ones. It was felt that the consolidation of the country's banking resources was a natural and necessary corollary to the increase of large-scale production and the growth in the size of the industrial unit, and that only by this means could British industry be given the financial accommodation it would need in meeting competition after the war. There was no doubt a good deal of reason in this argument, but it must at the same time be admitted that the spirit of rivalry between the banks was a powerful influence, and that when once the movement had started, it received a strong impetus from the am-

[5] "Economist" Banking Supplement 29th May, 1926. p. 11.

bition of each bank to outstrip its contemporaries in size, and at all costs to avoid being left in a position of inferiority in point of deposits.

Committee on Amalgamations. These rapid developments provoked a good deal of criticism and fears were expressed that the concentration of the country's financial resources was reaching a stage at which freedom of competition among the banks would be seriously restricted. In view of these apprehensions that the movement might end in the formation of a money trust, which would be contrary to the national interest, a committee was appointed by the Chancellor of the Exchequer in March, 1918, to consider the whole question. The Committee came to the conclusion that "the possible dangers resulting from further large amalgamations are material enough to outweigh the arguments against Government interference, and that in view of the exceptional extent to which the interests of the whole community depend on banking arrangements, some measure of Government control is essential."[6] The Committee therefore recommended that legislation should be passed as soon as possible requiring that the consent of the Government should be obtained before any amalgamation could be announced or carried into effect. As a general principle for the guidance of the Government in considering whether any particular proposal for amalgamation should be sanctioned, the Committee suggested that "a scheme for amalgamating or absorbing a small local bank or any scheme of amalgamation designed to secure important new facilities for the public or a really considerable and material extension of area and sphere of activity for the larger of the two banks affected should normally be considered favorably, but that if an amalgamation scheme involves an appreciable overlap of area without securing such advantages, or would result in undue predominance on the part of the larger bank, it should be refused."

Treasury Agreement. A bill was in due course brought forward to give effect to the recommendations of the Committee, but it was withdrawn before it became law, an agreement having been made between the banks and the Government that no further arrangements for amalgamation would be entered into without

[6] Report of the Treasury Committee on Banking Amalgamations 1918. Cd. 9052.

the consent of the Treasury. This agreement is still in force, and a standing Committee of two members now considers all schemes of amalgamation, and advises the Treasury as to whether its sanction should be given or withheld.

No further amalgamations of similar magnitude to those just described have since taken place, but several more small local banks have been absorbed by larger ones and there have been various affiliations between English and Scottish or Irish joint stock banks. These affiliations have been effected through the purchase of the greater part of the capital of the Scottish and Irish institutions by the English banks, the Scottish and Irish banks retaining their legal entity. This form of union has been preferred to complete amalgamation because in the latter case the Scottish and Irish banks concerned would have lost their rights of note issue.

Present Banking Position. As a result of this movement which has been in progress for a century and was so greatly intensified during the war, there are now only 16 joint stock banks and one private bank [7] operating almost exclusively in England and Wales. It must be pointed out that in this connection we include under the term " bank " only those institutions whose main business is the receipt of money on current or deposit account and the granting of loans, the money on current account being available to be drawn on by check. We exclude the London finance houses of various types whose business, although it is banking in the broader sense of the word, does not come under the definition just given.

Of the joint stock banks mentioned above, five stand out from the others by reason of their exceptional size. These are the Midland Bank, Lloyds Bank, Barclays Bank, Westminster Bank, and National Provincial Bank (arranged according to the total of deposits held) and they are known in common parlance as the " Big Five." On the 31st December, 1925, the total deposits of the 18 English joint stock banks amounted to £1,806,810,000,[8] and of this amount, the deposits of the Big Five accounted for no

[7] The " Economist " Banking Supplement referred to below shows eighteen joint stock banks and four private banks. Two of these joint stock banks, however, and three of the private banks do not come under the present definition of a bank.

[8] " Economist " Banking Supplement, 29th May, 1926.

less than £1,513,935,000. It will readily be seen therefore that by far the greater part of English banking business is in the hands of these five institutions.

LEGAL CONSTITUTION OF THE JOINT STOCK BANKS. With regard to the legal regulation of British banking there is little to be said. Apart from the prohibition of note issue by banks in England, and the stipulations as to annual returns mentioned below, the banks of the United Kingdom, as banks, are not subject to any special legal provisions. The banks coming within our definition, with three exceptions, are limited liability companies incorporated under the Acts of Parliament governing the formation and conduct of companies in general. A few of the English banks operating in the colonies, and two or three of the Scottish banks are incorporated by Royal Charter, while a few of the London finance houses are private partnerships subject to the law of partnership, but these institutions do not come within the scope of this section.

REGISTRATION. Any banking business owned by more than ten persons must be registered as a company. The most important preliminary to registration is the filing of the company's Memorandum and Articles of Association with the Registrar of Joint Stock Companies. These documents, which must conform to certain rules prescribed by law, define the objects and powers of the company and lay down the general regulations under which it is to be administered. When registration has been completed, the company becomes a legal entity, and acquires the important privilege of limited liability, which means that the shareholders cannot be made liable for any sums beyond the nominal amount of the shares they hold. All companies incorporated under the Annual Returns Acts must include in their titles the word "limited."

REGISTRATION OF STOCKS. Once incorporated, the company must send every year to the Registrar of Joint Stock Companies among other information a list of shareholders, and an audited balance sheet showing its capital, liabilities and assets. This obligation is common to all limited companies. Banking companies working under the Acts are required in addition of file a list of places where they carry on business. The legal requirements in connection with balance sheets sent to the Registrar are very loose, no special form being laid down for the balance sheet

or the auditor's certificate, and there is consequently considerable scope for misrepresentation in the case of unscrupulous companies. The particulars filed with the Registrar are available for inspection by the public, but such provisions for giving publicity to the affairs of companies are not of much practical importance as far as banks are concerned, as British banks are accustomed of their own accord to give wide publicity to their balance sheets. Banking firms conducting business in England or Wales, but not incorporated under the English Companies Acts, are required to send to the Inland Revenue Office once a year a return showing the names and addresses of the members of the firm and the places where business is carried on.

The Acts further stipulate that a general meeting of the shareholders shall be held at least once a year. In recent years, it has become the practice of bank chairmen in presenting their annual reports to give a general survey of financial and economic conditions, or a disquisition on economic or monetary theory, and the annual meetings of the banks are consequently of considerable public interest.

Private Limited Companies. The Companies Acts also provide for the formation of what are known as "Private Limited Companies." These companies are similar to those described above, with the exception that the number of shareholders is limited to fifty, the right to transfer shares must be restricted, and no invitation may be issued to the public to subscribe capital. Such companies are exempt from the obligation to file a balance sheet with the Registrar. Some of the smaller London banks are incorporated in this form, which combines the advantages of an ordinary business partnership with the privilege of limited liability.

The amount of the capital of the company is stated in its Memorandum, and when the Memorandum has been registered, this amount becomes the authorized capital of the company. Not all of the authorized capital, however, need be issued, and a part of it is frequently reserved for possible future issue. Nor need the whole of the issued capital be paid up; it is indeed usual in the case of English banking companies for only a part of the capital to be paid up, the remainder being available for call as occasion demands, except where provision is made for part of the unpaid

capital to be callable only in the event of the liquidation of the bank.

The Balance Sheet of the Big Five. We now pass to a brief consideration of the part played by the joint stock banks, as revealed by their balance sheets, in the financial system of the country. The table shown on the opposite page is the combined balance sheet of the Big Five as on the 31st December, 1925, to which has been added the proportion of each item to the total of liabilities and assets respectively.

Capital. This is all in the form of ordinary shares, there being no instance among the large English banks of the division of capital into preference and ordinary or deferred shares. In some cases, however, the capital of a bank is divided into two classes, one being fully paid and the other partly paid. Both rank equally for dividend, but the fully paid shares are frequently limited to a certain maximum rate. The uncalled liability on the partly paid shares is equivalent to an additional reserve fund, although in view of the small proportion which it bears to the total liabilities, the protection thus afforded to the depositors is not of any great importance. The protection is, however, in some cases increased by a provision that a certain amount of the uncalled capital shall only be callable in the event of the liquidation of the bank.

Proportion to Liabilities. It will be noticed that the proportion of capital to total liabilities is exceptionally small in English banks as compared with that generally maintained in other countries. This accounts for the high rate of profit which English banks have been able to earn on their capital. It is also one of the reasons why English banks prefer not to make loans for long periods, the fact that they work to such a large extent with borrowed money making it desirable for them to seek securities which can be quickly realized and which are as far as possible self-liquidating.

Reserve Fund. The reserve fund represents amounts which have been allocated from profits from year to year to form a reserve against contingencies. The figure shown cannot by itself be regarded as an accurate indication of the reserve resources of the banks, as it is well known that the banks also carry considerable " hidden reserves " in the form of investments (especially premises) written down to, and consistently maintained, at a fig-

COMBINED BALANCE SHEET OF THE BIG FIVE AS ON THE 31ST DECEMBER, 1925

Liabilities	£ s d	Percent of Total	Assets	£ s d	Per cent of Total
Capital paid up..........	61,161,846......	3.5	Cash in hand and with the Bank of England..	198,824,287. 4. 8	11.5
Reserve Fund............	50,446,518......	2.9	Balances with, and checks in course of collection on; other Banks in the British Isles..........	59,363,461. 2...	3.4
Current, Deposit and Other Accounts.............	1,513,935,137. 9.11	87.5			
Acceptances, Engagements, etc., for account of Customers................					
Undistributed Profits.....	97,198,428.12. 6	5.6	Money at Call and Short Notice...............	105,710,850. 9. 4	6.1
Notes in Circulation in the Isle of Man...........	8,132,497.14. 5	0.5	Bills Discounted........	191,421,420. 9.10	11.1
			Investments............	259,158,459.11. 1	15.0
	15,487......	.....	Advances to Customers and Other Accounts...	793,240,069.13. 4	45.8
			Liability of Customers for Acceptances, Engagements, etc., as per contra..............	97,198,428.12. 6	5.6
			Bank Premises.........	25,972,937.14. 1	1.5
	1,730,889,914.16.10	100.0		1,730,889,914.16.10	100.0

ure below market value. This fund, moreover, is never in practice drawn upon, as further reserves are maintained to meet contingencies. The total of these latter funds is not shown separately, being included in the deposits, but they are believed to be more than adequate for their object. It will be noticed that the reserve does not fall far short of the paid-up capital.

Current, Deposit, and Other Accounts. To the practical banker, this item is the measure of the resources available for the conduct of his business; to the economist, it is an index to the credit position of the country. As loans expand deposits increase, for an overdraft in the books of one bank becomes a deposit in the books of the same or another bank, and when credit is contracted, deposits show a corresponding decrease. Variations in the total of deposits are thus intimately connected with trade movements.

The deposits of British banks fall into two classes — the balances on current account and the balances on deposit account. Current accounts are those which can be drawn on by check, the money being payable on demand. It is not customary to allow interest on the balances of these accounts, the banker having the use of the money in return for his services in conducting the account. If, however, the balance maintained is not sufficient to remunerate the banker for the work done, he makes up the deficiency by charging a commission. In the case of deposit accounts, the balance is not usually available to be drawn on by check, and is generally subject to seven days' notice of withdrawal, although special arrangements are sometimes made for shorter or longer terms of notice. As the work involved in keeping deposit accounts is much less than in the case of current accounts, and the banker has also ordinarily the right to notice of withdrawal, he is able to allow interest on the balance, at a rate nowadays generally fixed at 2 per cent. below Bank rate. It should be added that in practice, bankers seldom avail themselves of the right to notice of withdrawal and are usually willing to repay on demand. A slightly higher rate is allowed on deposits for a fixed period, but there is no uniform scale of interest for these accounts, the rate being a matter of negotiation.

Growth of Deposits. The deposits of the banks have increased to a very great extent in recent years. This has been due

primarily to the inflation of currency and credit during the war period, and in a lesser degree to the extension of the banking habit, as a result of which there has been a considerable increase in the proportion of payments made by check to those made in cash, with corresponding economy in legal tender money. This of course is not to say that the currency in circulation is less now than before the war; it is in fact much greater, but the increase would have been even more pronounced if the use of banking facilities by the public had not increased.

It may be well to give here the legal definition of a check. This is contained in the Bills of Exchange Act, 1882, which is the basis of the law relating to bills of exchange and checks. The Act defines a bill of exchange as an "unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer." In a later section of the Act, the check is defined as "a bill of exchange, drawn on a banker payable on demand." All checks are subject to a fixed stamp duty of twopence, which is thought by some people to be unduly high, and therefore to discourage the extension of the use of banking facilities by the public, with its attendant advantages of economy in legal tender currency.

Acceptances and Engagements. The greater part of the liability under this heading is no doubt in respect of bills accepted by banks on behalf of their customers. These acceptances are concerned almost entirely with foreign trade, and comprise bills accepted by the banks on behalf of home importers, often against deposit of the documents of title to the goods concerned. Engagements include commitments in connection with forward exchange. The whole of this item is offset by the liability of the customers shown on the assets side.

Undistributed Profits. This item speaks for itself. It generally includes the amount available for paying the final dividend for the year.

Notes in Circulation. This small item refers to the note issue of a bank, formerly operating in the Isle of Man, which was not subject to English banking law, and was taken over some years ago by one of the English banks.

Cash in Hand and with the Bank of England. Under this heading are included all the cash resources of the banks. It is a defect of the British bank returns that the balances with the Bank of England are not shown separately from the actual currency held. As the Bank of England itself does not show a separate total for the bankers' deposits which it holds, it is impossible to ascertain the exact extent to which the joint stock banks are dependent on the Bank of England for supplies of cash to meet any abnormal demands for currency on the part of the public. The grouping of cash in hand with the balances at the Bank of England tends to give the impression that the latter are as liquid an asset as cash in hand. This is far from being the case, for, although the amount of bankers' balances included in the "Other Deposits" shown in the Bank of England returns cannot be ascertained, it may be surmised that the cash resources of the Bank would not be sufficient to liquidate the whole of the bankers' balances at any one time, especially as exceptional demands by the bankers would probably coincide with heavy demands for cash by other depositors of the Bank. Balances at the Bank of England therefore can be regarded as the equivalent of cash in hand only if it be assumed that in the event of any exceptional stringency, the Government would come to the rescue of the Bank by sanctioning an increase in the fiduciary note issue beyond the limit imposed by the Bank Charter Act or otherwise providing additional currency. There is in fact legislation in force at the present time under which the fiduciary issue can be thus expanded, but this is a survival of the war period, and it is not yet certain whether it will be made permanent.

It is generally understood that the cash held by the banks is little more than is necessary to provide for the cash requirements of their customers from day to day. The currency held is in the form of Bank notes, currency notes, and silver and copper coin, the amount of gold being negligible. As will be explained later, the gold in circulation was drawn into the banks at the outbreak of war in 1914, and subsequently passed on by them to the Bank of England. It has not since been restored to circulation.

Balances and Checks. In English banking, it is usual to give customers credit for checks on other banks as soon as they are paid in for collection, except in the case of certain London

offices which do not give credit for country checks until they are cleared. Consequently at the close of the day's business, each bank holds as an asset a large number of checks drawn on other banks, which will be put forward for clearing the next day. In the case of any one of the Big Five, the greater part of this item will consist of checks on the four other big banks, and as we are here dealing with the combined balance sheets of the Big Five, in order to approximate more closely to the net total of the deposits the checks in course of collection should be deducted from the deposits shown on the liabilities side. It should be mentioned that in the case of one of the Big Five, this item is not shown separately, but is included in Cash.

Money at Call and Short Notice. Next to the cash in hand and at the Bank of England and balances with other banks, the money at call and short notice is the most liquid of the banks' assets. It consists entirely of loans to bill brokers and Stock Exchange firms on the security of bills of exchange and Stock Exchange securities. The greater part of these loans are made for fixed periods of a week or at most ten days. A smaller amount is lent to the bill market from day to day, such loans commanding a lower rate of interest than those for longer periods. When the banker requires to strengthen his cash position, he can do so merely by refraining from renewing his short-term loans as they mature. Money lent at call or short notice does not of course earn such a high rate of interest as the ordinary bankers' advances, and the rates are particularly sensitive to variations in the supply of money in the market. More will be said on this subject later when we deal with the bill brokers, and with the general working of the money market.

Bills Discounted. This item comprises bills of two types — trade bills and Treasury bills. The trade bills are purchased from the banks' customers, or from bill brokers and run for varying periods up to three months, and occasionally up to six. The English banks play a large part in the financing of overseas trade, and a certain proportion of the trade bills are no doubt foreign ones. Treasury bills are offered for sale by the Government from week to week, and are a form of more or less permanent though floating Government debt, the amount outstanding being so large that it can be reduced only by small steps. This method of rais-

ing money was introduced during the war, and at present the proceeds are used to pay off outstanding bills as they mature. Treasury bills naturally form an ideal banking investment, except of course that the interest yield is lower than that obtained from advances and trade bills. They have the liquidity of bills of exchange, and are at the same time a British Government security.

The fact that no distinction is made between trade bills and Treasury bills in bank balance sheets renders the total of bills discounted unreliable as an indication of the extent to which the banks are financing trade by this means, for although the two types of bill are similar from the banker's point of view, to the economist they have little in common. Variations in the total may be due to changes in the holdings of either trade bills or Treasury bills, and it is possible for considerable sums which had been lent to the Government to be withdrawn and employed in financing trade without any alteration in the total of bills discounted, the banker merely allowing Treasury bills to run off, and buying trade bills with the proceeds. The proportion of discounts to advances has in recent years shown a decline, which is probably due to the growth of joint stock enterprise, under which it is apparently found more convenient to borrow by means other than the discounting of bills.

Investments. The banks do not give full details of the composition of this item, but sufficient particulars are given to show that the investments are all of the gilt-edged type, and that a very large proportion consists of securities of the British Government. No money is lent to industry under this heading, as the banks prefer not to lock up their funds in industrial enterprises to the extent which would be necessary if they made a practice of holding the stocks, shares or debentures of industrial companies.

The investments show considerable variation from time to time in accordance with the requirements of trade and industry. When the commercial and industrial demand for accommodation expands, it is chiefly by the sale of investments that the banker provides the additional funds required. Conversely, in times of trade depression, any money which is no longer required for industrial finance flows back into the category of investments.

It should be added that the total of investments includes capital held by the Big Five in affiliated Scottish and Irish banks, and foreign and other auxiliaries.

Advances to Customers. This item is the most important channel for the employment of the banks' funds. The loans are either by way of overdraft on current account, or on separate loan account. In the latter case, the loan is debited to the customer's loan account, and credited to his current account. The principle underlying the granting of loans by British banks is that no part of their funds shall be permanently locked up in any one enterprise. They refuse as far as possible to make loans to any customer who cannot see his way to repaying the loan within a reasonable time either in one sum or by instalments. This of course does not mean to say that large sums are not advanced to industrial enterprises. On the contrary, advances to joint stock companies on the security of either specific property of the company or a floating charge on its assets are a usual feature of banking business; but such loans would not be made for indefinite periods. They would rather be made to cover a temporary shortage of working capital, and if the position of the company did not within a reasonable time become sufficiently liquid to enable it to repay the loan, arrangements would have to be made by the company to raise capital by the recognized methods of permanent company finance, and to repay the bank loan with the money raised.

The advances are made on various types of security. The kind most favored by the banker is the good class Stock Exchange security which besides being generally marketable, has a definitely ascertainable value which can be watched by the banker during the currency of the loan. Security in so convenient a form, however, is not always forthcoming, and in its absence, the banker accepts deposit of title deeds of real or leasehold property, guarantees, life insurance policies, and documents of title to goods. The rate of interest is in the ordinary course determined by Bank rate, being fixed at a certain amount, usually 1 per cent, above the central institution's rate of discount with a minimum of 5 per cent. This obviously is an advantage to the banker for, as the rate of interest he pays on deposits also moves with Bank rate, he can, so far as the amount of his advances to customers

is concerned, count on a fixed margin of profit which is not affected by movements in the price of money.

The total of advances to customers varies roughly in accordance with changes in the volume of trade. In times of expanding trade, the demand for loans increases, and at such times, in view of the vastness of the resources at their disposal, the banks are placed in a position of national responsibility, for by discrimination in granting loans, they can do much to check excessive speculation and prevent the trade position from becoming unsound.

Liability of Customers and Bank Premises. These two items are self-explanatory. It may be remarked, however, that the premises probably stand at a figure considerably below their market value and are therefore a concealed source of strength.

In addition to their annual balance sheets, the London clearing banks issue at the beginning of each month returns showing their position during the previous month. The figures given in these returns are the averages as on a certain fixed day of each week during the preceding month. The figures are useful as showing the positions of the individual banks, and the combined figures give a general indication of the banking position, but their value is somewhat lessened by the fact that the banks have not all chosen the same day of the week as a basis for their figures. There is further a tendency for the banks to strengthen their cash positions on the day chosen as a basis for the returns in order to make a good showing — a practice which is also resorted to in a much greater degree at the end of the year before the publication of the annual balance sheets.

The Scottish Banks. The development of banking in Scotland has been roughly contemporary with the course of events in England. The Bank of Scotland, which for some time after its establishment occupied a position analagous to that of the Bank of England in English banking, was founded by the Scottish Parliament in 1695, Scotland being then distinct, politically, from England. It is noteworthy that the Bank of Scotland, in contrast to the Bank of England, was founded primarily to further the progress of commerce and industry and not with the object of rendering financial assistance to the Government. Modern developments have considerably modified the influence of the Bank

of Scotland as the center of Scottish banking, and Scotland nowadays can hardly be said to possess a separate money market of its own. The Scottish money market must rather be regarded as affiliated to the London market, and the Scottish banking system as part of the British system as a whole. All the large Scottish banks have offices in London, and are in close touch with the London Money Market.

Essential Characteristic. Nevertheless, Scottish banking has always differed, and still differs in one important feature from banking in England — that is with regard to the issue of notes. Scotland has in the past been less rich in natural resources than England, and an abundant supply of credit has therefore been indispensable for the development of her economic resources. This credit has been supplied by the issue of notes, by means of which the banks have been able to assist Scottish industry to an extent which would have been impossible if the right of note issue had been restricted as it was in England. The importance of this feature of Scottish banking was recognized in the Scottish Bank Notes Act of 1845, which now governs the Scottish note issues, and which gave the Scottish banks much wider powers of issue than were allowed to their contemporaries in England. By this Act, the right of issue was confined to banks already exercising the privilege, and each such bank was authorized thenceforth to have in circulation an amount of notes equal to its average circulation during the year ending on May 1, 1845, plus the average amount of gold and silver coin held at its head office from time to time (both these amounts being based on averages over successive periods of four weeks). The coin was not, however, to be earmarked as a reserve against the notes, but merged in the general assets of the bank. The minimum denomination of the notes was fixed at £1, and it was provided that any banks which amalgamated could continue to issue notes to the amount of their aggregate issues before amalgamation.

The Classic Banking System. By prohibiting the establishment of further note-issuing banks, the Act virtually gave a monopoly of banking business in Scotland to the banks already in existence in 1845, as it is commonly supposed to be impossible to conduct a non-issuing bank profitably in competition with banks which enjoy the right of issue. This belief is borne out to some

extent by the fact that no new bank has succeeded in establishing itself in Scotland since 1845.

The Scottish Banks, besides realizing the advantages of note issue, have developed the check system on the same lines as have been followed in England. They have thus availed themselves very fully of the possibilities of banking as an aid to industry and commerce, and it is because of this completeness of their system that it has been called the classic banking system of the world. Judged by the success with which it has mobilized and used all the available capital for the furtherance of economic development, and by the comparative freedom from financial crises which Scotland has enjoyed, there would appear to be good grounds for this description, and certainly the Scottish system is the one which has been most widely copied in other countries. This however does not necessarily mean that the Scottish system should have been followed in England, or that the English system has not proved well adapted to the country's particular needs and circumstances.

Banking in Scotland is now in the hands of eight banks which are all of the joint stock type, the last private bank having disappeared as long ago as 1843. Of these eight, four are controlled by English joint stock banks which own the greater part of the capital of their affiliated Scottish institutions. From the point of view of legal constitution, the banks are of two kinds, some being incorporated by charter, and some under the Companies Acts. Of the latter type, a few were originally incorporated by charter without the privilege of limited liability, but have since gained this quality by registration under the Companies Acts, so that all the banks now enjoy limited liability.

Services Rendered by British Banks. The leading functions of British banks, as will have been gathered from the foregoing pages, are the receipt of money on current and deposit account (money on current account being available to be drawn on by check) and the employment of a substantial part of their lodgments in the provision of working capital for commerce and industry. In addition to these primary functions of deposit and remittance banking, they also render to the public all the services which are generally understood to comprise banking in its broadest sense. The chief of the subsidiary services is the general

handling of investments. Besides accepting securities for safe custody, the banks undertake the purchase and sale of stocks and shares on behalf of their customers. It is not their practice to deal in securities themselves, such transactions being invariably effected on the Stock Exchange through the medium of a broker. There is an arrangement in force with the London Stock Exchange whereby the brokers pay over to the banks one half of their commission on all transactions which they effect on behalf of customers of the banks, so that persons doing Stock Exchange business through their banks do not have to bear any extra expense.

An equally important service rendered by the banks is the transaction of all kinds of foreign business, including the purchase and sale of exchange, the negotiation of clean and documentary bills and the opening of commercial credits. This is undertaken by the foreign departments of the joint stock banks, which have correspondents in all the chief towns of the world.

In comparatively recent years, the banks have extended their operations to include the undertaking of all kinds of trustee business. This innovation was introduced a few years before the war, and has proved very successful. All the chief English banks now have trustee departments through which they act as executors and trustees of wills, trustees of settlements, and trustees in connection with issues of debentures. Such duties were before the war undertaken almost entirely by private persons, but it is a type of business which the banks are well fitted to undertake by reason of the confidence they naturally inspire, their close knowledge of investments, and the continuity of management which is secured by appointing a corporation as opposed to a private person. It is probable therefore that the activities of the banks in this direction will increase in the future.

The Clearing System. As might be expected in a country where remittance banking has been so highly developed, British banks have for many years had the advantage of expeditious and efficient clearing facilities. In certain of the large provincial towns, the banks have established small clearing houses where their representatives meet and exchange checks drawn on the branches in the town itself, while in the smaller towns representa-

tives of the banks call on each other to exchange local checks. With these exceptions the whole of the clearing for England and Wales is done through London. Here there is a large clearing house where representatives of the banks are constantly engaged in the work of settling their claims on each other.

Membership of the clearing house is limited to eleven of the big London banks, including the Bank of England. Other banks which are not themselves members of the clearing house keep accounts with one or other of the clearing banks who act as their agents for clearing purposes, and the branches of the clearing banks clear through their respective head offices.

The clearing is organized in three sections — town, metropolitan, and country. The town clearing deals with checks drawn on clearing banks in the City itself, the metropolitan section handles checks drawn on clearing banks within the London metropolitan area, and the country clearing covers the whole of the remainder of the country with the exception of the local clearings referred to above. The three clearings are all carried out in the same building, but at different times, and the procedure is roughly the same in all cases. The clerks of each bank exchange the checks on other banks which they hold against the checks on their own bank held by other banks; total of the amounts due from each bank to each other bank are arrived at and agreed, and at the end of each clearing the differences between the various banks are settled by transfers between their respective accounts at the Bank of England. In this way, the vast number of transactions which are carried through every day all over the country through the medium of the check are eventually settled by entries in the books of the Bank of England without any necessity for handling cash.

Clearings and Trade. The clearing figures are to some extent an index to trade conditions, but in this connection they must be used with caution. The town clearing is largely affected by purely financial operations such as money market and Stock Exchange transactions, and its figures bear no very close relation to the volume of trade. The metropolitan clearing, however, reflects roughly the state of retail trade in London, and the country clearing totals may be regarded as an indication of general trade conditions all over the country.

The following are the totals of checks passed through the respective clearings in 1925: —

London Clearing:	
Town	£35,801,264,000
Metropolitan	£ 1,678,347,000
Country	£ 2,957,508,000
Ten Provincial Clearings in England	£ 1,789,488,000

London's Overseas Banking Connections. Just as the British nation depends for its subsistence more on overseas trade than any other country, so is London an international banking center to a greater degree than any other city in the world. This characteristic London owes to the widespread nature of its own trading connections, the freedom of its gold market, and the absence of any restriction on the establishment of branches in England by foreign banks.

To deal with the foreign connections of the English banks themselves — each of the Big Five has in London a separate department, called the foreign or overseas branch or department which is specially concerned with the bank's foreign business. These branches undertake all the transactions generally described as foreign banking. They keep accounts in the various currencies, handle foreign trade bills, act as agents for foreign banks, arrange credit facilities for travellers in all parts of the world, and transact a large business in foreign exchange. In this way, in coöperation with their agents in foreign countries, the English banks are able to render important services to the nation's foreign trade. This branch of British banking is a development of recent years. It was commenced a few years before the war, and grew up largely during the war period and immediately afterwards.

Foreign Branches. British home banks are, so far as England is concerned, free also to establish branches in foreign countries, but the steps taken in this direction have not gone very far, and further extension seems unlikely at present. One of the Big Five has refrained as a matter of policy from the establishment of branches outside England and Wales, but the other four now have foreign auxiliaries with branches in the more important towns of France, two have offices in Belgium, and one of them recently opened branches in Rome and Genoa. During the war, one of the banks went a little farther afield, and opened branches

in Spain, but the experiment was apparently unsuccessful as these branches were closed in 1923 — probably on account of trade depression and Spanish legislation designed to discourage the establishment of foreign banks in that country. The opening of branches abroad having been pursued only to this limited degree, it may be concluded that British banks find that business can be conducted more conveniently through foreign correspondents and affiliations than by direct representation abroad.

An interesting step has however been taken recently by Barclays Bank, one of the Big Five, towards the coördination of banking facilities within the Empire. By means of the fusion of three banks working in different parts of the Empire, mainly in Africa, a subsidiary bank with wide imperial connections has been formed by Barclays Bank to work in close coöperation with the parent institution, by which it will be controlled. As a result of this arrangement, Barclays Bank is now represented through its subsidiary in a large number of towns in the West Indies, Egypt, and Palestine, and in practically every part of Africa under the British flag, as well as in parts of foreign Africa.

Such are the overseas connections of the English banks. There are in addition in London branches of all the more important banks of the world which engage in international business. Foreign banks are free to establish branches in London without any restriction, and to work under the same conditions as British banks, and there can be no doubt that their presence in London has been beneficial both to their own countries and to the United Kingdom.

STATISTICAL APPENDIX TO SECTION ON JOINT STOCK BANKS

Names of the individual banks involved in amalgamations are too numerous to be given here. For these particulars, reference should be made to Appendix II to Mr. Sykes's book mentioned above.

Details of changes in the names of banks are listed in the Bankers' Almanac (published annually by Thomas Skinner & Sons).

No coördinated statistics of banking resources involved in amalgamations are available.

OTHER CONSTITUENTS OF THE MONEY MARKET

The Merchant Bankers. The joint stock banks are responsible for by far the greater part of English banking business properly so called, but there is in the London money market another group of banking houses which specialize in a branch of business which English bankers do not include among their main functions, although they have been giving increasing attention to it in recent years — the acceptance of bills of exchange. These firms are known as merchant bankers or acceptance houses. Most of them are very old established firms, and the large number of foreign names among them is evidence of the prominent part played by foreigners in building up England's financial connections abroad in the days when domestic banking was still in its infancy.

Most of these houses started business as merchants pure and simple. In course of time, as their trade expanded, they became well known in various parts of the world both for the extent of their business, and for financial reliability. Small traders abroad, who were not known outside their own cities, finding difficulty in establishing their credit when dealing with other countries, found that matters were simplified if they arranged for these merchants of high standing to accept their bills for a commission. The merchants were in a good position to do this because, through their agents in other cities, they were able to get reliable information as to the position of the traders whose bills they were to accept. The arrangement commenced with the acceptance by the London merchants of bills drawn by Englishmen on the foreign traders, but was soon extended to bills drawn by and on countries other than England, in respect of produce with which England was not concerned. Finding the business profitable, these particular houses gradually relinquished their activities as merchants and gave more and more attention to the acceptance of bills.

Nowadays, this forms their main business, but they also keep

current accounts and act as agents for foreign bankers. Besides this, the larger of them do an extensive business as agents for foreign governments, which involves the flotation of loans, and work incidental to this type of borrowing such as the receipt of remittances for the service of the loans, and the payment of coupons and drawn bonds. Some of the merchant bankers continue to work as private partnerships, but many of them have converted their businesses into private limited liability companies. A few of the merchant bankers are also dealers in bullion.

The Bill Brokers. The organization of its discount market is a characteristic feature of the English financial system, for the London money market is peculiar in having a separate group of firms who concentrate their attention entirely on the discounting of bills of exchange. In no other financial center do there exist such highly developed facilities for both lending and borrowing on the security of bills.

The firms which engage in this business are of two types. First there are the big discount houses. This group consists of three public joint stock companies and a few old established private firms. Their own capital forms only a small proportion of the resources with which they operate. The remainder of their funds they obtain by accepting deposits, on which they pay a rate of interest slightly higher than that paid on deposits by the banks, and by borrowing at call and short notice from the banks. These funds are employed in the discounting of bills which are bought from the foreign and colonial banks, and from the mercantile community in general. The greater part of the bills are bought for holding, but some are retailed to the banks.

Discount House Resources. The discount houses do not lock up the whole of their resources in bills, but retain a small reserve of cash in hand and at bank, and a larger amount of short-dated gilt-edged securities. Their position is therefore a strong one from the point of view of the depositor for, apart from the cash in hand and securities, the bills of exchange in which the greater part of their funds are employed are a liquid investment, and the number of bills handled makes it possible to spread the risks widely. The three public companies referred to above were in 1923 conducting as much as one half of the total discount

business of the market.[9] The following is the combined balance sheet of the three companies as on the 31st December, 1925.[10]

Liabilities	£	Assets	£
Capital & Reserves	5,660,111	Cash at Bankers	2,430,581
Loans, Deposits & Other Accounts (including undivided profits) ...	87,761,782	Investments	10,507,827
Bills Rediscounted	33,992,487	Bills Discounted	110,482,583
Rebate on Bills not due	1,499,929	Loans and sundry accounts	5,493,318
	128,914,309		128,914,309

Private Firms. The second group of firms operating in the discount market are the private firms of bill brokers who discount bills mainly with the object of reselling them at once to the banks at a rate of discount slightly lower than they themselves gave for the bills. Like most other dealers, the bill brokers require to carry a stock of the commodity in which they deal — in this case, bills of exchange, and for this purpose they must have a certain amount of money at their disposal. This is provided to a very small extent by their own capital, and to a much greater extent by the loans which they obtain from the banks. Indeed, this class of bill broker and the discount houses previously referred to are the chief users of the money at call and short notice which appears in all bank balance sheets.

The existence of the bill brokers and discount houses is of great benefit to the London banks, as these loans to the market provide them with a means of employing profitably any portion of their resources which it is not desirable to place in the less liquid forms of investment, and any surplus funds they may have on hand from day to day. Money so employed can be called in almost at once as occasion demands. The position of the brokers themselves is somewhat precarious, for in times of monetary stringency, they are the first to feel the strain, and always run the risk of having to pay a higher rate of interest for their money than the rate at which they have discounted the bills they are

[9] J. Sykes's "The Amalgamation Movement in English Banking 1825–1924." London: P. S. King & Son. 1926, p. 175.

[10] The figures are taken from the "Economist" Banking Supplement 29th May, 1926.

carrying. We shall return to this subject at a later stage, when dealing with the general working of the money market.

Work as Retailers of Bills. The bill brokers and discount houses, besides being useful to the banks as borrowers, render them important service as retailers of bills. The bankers themselves have neither the time nor the opportunity to acquire a specialized knowledge of the bill market, whereas the bill brokers in the course of their business are able to become intimately acquainted with the standing of the parties to the hundreds of bills which come into the market. They not only have at their finger tips the most up-to-date knowledge as to the credit of the parties to the bills, but also they know roughly the amount of paper of any one firm which is circulating in the market, and can estimate whether any of the houses are entering into commitments greater than their resources would justify. For these reasons, the banks, apart from bills which they discount for their own customers, are content to leave it to the bill brokers to provide them with such bills as they wish to buy, knowing that the brokers are always ready to sell them parcels of bills of any maturity they may require, and that the brokers will, for the sake of their own credit and standing, buy and pass on only such bills as they feel confident will be met in due course.

There are also in the market a few brokers, called "running brokers," who act merely as intermediaries between people who wish to have their bills discounted, and banks who wish to buy the bills. These brokers never become parties to the bills, and never pay for them, working merely on a commission basis. The running brokers have been superseded to a large extent by the two types of firm just described, and are now practically obsolete. They are nevertheless of historical interest, for they were the real founders of the discount market in London, and were established there as long ago as the beginning of the 19th century.

The Foreign Exchange Market. The foreign exchange market in London in its present form has grown up largely since the war. In pre-war days, London merchants concerned themselves as little as possible with foreign currencies, overseas business being transacted chiefly in sterling, and the tendency was to leave the risks and profits of exchange business to foreign centers. Ex-

change operations in London were mainly in the hands of the London branches of foreign and colonial banks, and a few private banking houses. A large proportion of the business was in long bills, by means of which dealers, in addition to exchange profits, took advantage of differences in discount rates between the various centers.

Growth of Foreign Exchange. Even before the war, however, methods were being modernized, and London was taking a growing interest in foreign exchange, as was shown by the establishment of foreign branches or departments in London by the joint stock banks to deal exclusively with overseas business. There had also commenced another development which has become a modern characteristic of the market — the increased attention to cable business. The violent fluctuations in rates which resulted from the disturbance caused by the war made it necessary for London merchants to assume a part at any rate of the risks of the exchanges; hence the greater interest taken in this branch of banking. At the same time the uncertainty of the outlook made it impossible to see as far ahead as is necessary when dealing with long bills, and as a result spot transactions began to take the place of the more common pre-war dealings in long bills. Another reason for the growth of the business was the expansion of the trade of the United States. The increase in the number of transactions to be carried through called for an improved mechanism, which took the form of greatly extended telephonic facilities by means of which the members of the market were linked together by a network of private lines.

Constitution of Market. The foreign exchange market in London to-day differs from that of most other centers in that there is no place where dealers meet in person to transact business. Before the war, dealers used to meet twice a week in the Royal Exchange, but these meetings were even then losing their importance, and have since the war ceased completely, so that nowadays business is done entirely by telephone. It is noteworthy that a similar tendency is beginning to show itself in continental centers where, although the sessions at the Bourses are still very animated, an increasing amount of business is being done by telephone.

The dealers in the London market are the foreign and colonial banks, the foreign branches of the joint stock banks, and certain

of the private finance houses, a few of whom direct their attention exclusively to foreign exchange. All of these institutions are in direct contact with the public. There are in addition some forty firms of brokers who as a general rule transact business only with the dealers, and do not come into contact with the public. Nor do the dealers do business with each other; they act simply as intermediaries between the public and the brokers. The brokers for their part do not work as principals, their function being to link up the various dealers with each other, putting those who wish to buy into touch with others who wish to sell. They are not holders themselves of the currencies in which they deal, but work on a commission basis. It should be added that the activities of the brokers are confined to London. Transactions by cable and telephone between London and foreign centers are carried through by the London dealers directly with dealers in the other centers. The London market of course deals largely in all foreign currencies. The greatest volume of business now is in dollars, with the French franc perhaps occupying second place. The business in eastern and South American currencies is of special importance as London is the only European center dealing in these currencies to any considerable extent.

Growth of Forward Operations. A feature of the market since the war has been the increase in forward operations as a result of the unstable condition of the chief European exchanges. The banks now quote forward rates for all the chief currencies, thus enabling traders dealing with foreign countries to eliminate the element of exchange risk from their transactions by covering themselves as soon as their contracts are made. The forward rate of exchange is the rate at which the banks are prepared to buy or deliver the foreign currency on a given future date, and is expressed as a discount or premium on the spot rate. The amount and direction of the difference between spot and forward rates are determined by market anticipations as to future movements in the currency concerned, and by differences in the interest rates for short-term loans in the respective centers. The banks are not involved in any risk in dealing in forward exchange since a forward sale to a customer is always covered by a forward purchase and a forward purchase from a customer is similarly offset by a forward sale, the market being sufficiently extensive to

enable these compensating transactions to be effected without difficulty. The forward exchange market has grown to its present dimensions largely in response to the need for such facilities during the financial instability of the post-war period, and as the restoration of stable currencies in Europe progresses, the importance of this branch of foreign exchange business will probably tend to decrease.

THE WORKING OF THE MONEY MARKET

The Position before the War. The money market of a nation, broadly speaking, comprises the whole of the organization whereby persons or institutions who have money to lend, whether for short or long periods, are able to place it with other persons or institutions (including the Government) who require to borrow money, either for their personal needs, or for the development of the trade or industry in which they are engaged, and in the case of the Government, for meeting expenditure which is not covered by revenue. In practice, however, it is generally found that the market for money divides itself into two sections: one dealing with floating money which for various reasons it is not desirable to lock up in any one enterprise, and the other with money which it is convenient both for the lender and the borrower to sink for long periods in trade or industry. The distinction between these two functions of finance is clearly defined in the United Kingdom, and the term " money market " is generally understood to refer rather to the market for floating capital than to that for fixed capital. This somewhat narrow application of the term is a convenient one for our purpose, and in this section only the short-term money market will be considered, the market for fixed capital being left for a brief description at a later stage. It must, however, be borne in mind that the two divisions of the market are really very closely connected and are constantly reacting on each other.

Monetary Organization. An account of monetary organization in England at the present time (May, 1926) has to make allowance for the fact that the transition to normal conditions after the disturbance caused by the war is not yet quite complete.

The financial mechanism has clearly not yet assumed its definite post-war form, and although it appears likely that the monetary system when it has reached this stage will not differ very materially from the system which obtained before the war, it would nevertheless be misleading to describe it as it now exists without reference to the events which led up to the present position and to the changes which will probably be made in the near future. In these circumstances, it is proposed first to describe the pre-war position of the money market, then to sketch the changes resulting from the war, and finally to indicate the steps which remain to be taken to complete the return to what may be called normal conditions.

The legal tender money circulating in England before the war consisted of gold, silver, and copper coin, and Bank of England notes in denominations of £5 and upwards. There were also notes of a few country banks in smaller denominations, but these were negligible in amount. In Scotland the circulation of bank notes was much larger than that of the English country banks as all the Scottish banks had the right of issue. Only a small proportion, however, of the total of business transactions was effected by means of coin or notes, their place having been taken to a large extent by the use of the check. This meant that the banks had manufactured a currency of their own, for the development of deposit banking involves in the main the addition of check currency to the metallic and paper money, and not merely the substitution of the check for so much currency. The banker does not retain the whole of his lodgments in legal tender money, but only such a proportion as experience has taught him will be sufficient to meet demands for cash. The greater part of the balance is employed in loans to customers — i.e., in giving to borrowers the right to draw checks on the banker. Checks thus drawn may be paid into the banks by the person who receives them from the original borrower and become the basis for a fresh advance, and this process may go on until the original deposit is multiplied several times over. All these deposits on current account give the right to draw checks to the amount of the deposits and so provide a supply of currency in addition to the ordinary legal tender money.

Checks and Legal Tenders. The volume of check currency,

however, was not independent of the amount of legal tender money in the country. On the contrary, prudent banking practice demanded that a certain though not rigidly defined ratio of cash to deposits should be maintained, and any contraction in the volume of legal tender money such as would follow a considerable demand for gold for export could not fail to be reflected in a curtailment of loans by the banks with a corresponding reduction in the volume of deposits. The monetary system therefore was really on a full gold basis, and was highly sensitive to variations in the quantity of gold held by the Bank of England and other banks.

The nation's principal gold reserve, as we have seen, was held by the Bank of England, and apart from the central bank's holding, there was no concentrated stock of gold in the country. The joint stock banks held little more than sufficient gold to cover their day-to-day needs, and their holdings, like the gold actually in circulation, tended to remain constant, allowing of course for seasonal fluctuations. Exceptional demands for gold such as arose when the metal was required for export were met from the reserve of the Bank of England, just as imports of gold resulted in additions to the Bank's reserve. In such circumstances it was natural and indeed essential that the Bank of England should be in a position to control the credit structure which was based on its gold holding. This control was exercised through the medium of the discount market.

Bank Rate and the Money Market. It will have been gathered from the foregoing pages that the chief lenders in the discount market were the banks, both English and foreign, and that the chief borrowers were the bill brokers. Among the lenders, the Bank of England occupied a somewhat peculiar position. In volume of resources it was overshadowed by the much larger joint stock banks, and in normal times the amount lent by the Bank to the market was negligible in comparison with the amount lent by the other banks. It was, and still is, the custom of the Bank every week (on Thursdays) to announce "Bank Rate" — that is, the minimum rate at which it is prepared to discount approved bills for parties other than its own regular customers, for whom it habitually discounted at market rates. One of the requirements of the Bank in connection with bills for discount was that they

should bear at least two English names, one of which must be that of the acceptor. It should further be mentioned that Bank rate also determined the rate charged by the Bank for short-period loans on marketable securities, this kind of accommodation usually being granted at $\frac{1}{2}$ per cent above Bank rate for periods of a week. Now Bank rate is always somewhat above the rate prevailing in the market for the discount of bills. Consequently, when the market is in equilibrium, that is, when the amount of money available for lending is roughly equal to the demands of borrowers at the existing rates, the funds of the Bank of England are not drawn upon apart from discounts for and loans to the Bank's own customers at market rates.

Control of Tendency to Inflation. Suppose, however, that a tendency towards inflation of credit develops. The consequent rise of prices discourages exports of goods and encourages imports, and with a relative falling off in the demand for sterling, the exchanges move against England. If this goes on for any considerable time, the result is an export of gold which is taken from the Bank of England's reserve, either directly by the exporter, or through another bank. In either case, Other Deposits and Gold Coin and Bullion at the Bank are reduced by the same amount, with a consequent reduction in the ratio of reserve to liabilities. Stringency begins to be felt in the short-loan market, for the market naturally has a close knowledge of such happenings, and even if it had not, the change in conditions would become clear with the publication of the weekly return of the Bank. The banks, who are the lenders in the market, with a view to strengthening their cash position begin to have recourse to their second line of defence, which is their short-term loans to the discount market, and are less ready to renew their holdings of bills as they mature from day to day. The result is felt in a rise in rates for short-term loans, and in the market rate of discount, until these rates come very close to the Bank of England rate. The borrowers in the market then turn to the Bank for accommodation.

Control of Market. When this point is reached, the Bank of England has full control of the market, for the borrowers, finding that sufficient funds are not forthcoming from the banks, which normally keep them supplied with money, are compelled

to borrow from the Bank of England, the only institution which is *always* prepared to lend — at the rate fixed by itself. Such borrowing increases Other Deposits and Other Securities without any addition to the reserve, thus further decreasing the ratio of reserve to liabilities. This compels the Bank, with a view to protecting its reserve, and therefore the interests of the market as a whole — for the Bank's reserve is the basis of the whole financial system, — to raise its rate of discount to whatever point it considers high enough to discourage borrowing and thus bring about the necessary contraction of credit. Under the influence of the higher rates thus established, less bills come forward for discount, while foreigners are encouraged to acquire balances in London. The increased demand for sterling abroad turns the foreign exchanges again in favor of this country and the outflow of gold is stemmed, and ultimately converted into an influx. As soon as this happens, the resulting improvement in the Bank of England's reserve relieves the stringency all through the market, and the banks are able to lend more freely. With these loans the market is able to repay the sums borrowed from the Bank. Market rates for loans and discounts fall, and Bank rate is correspondingly lowered, although it still remains at a point slightly above the market rate.

Gold and Prices. Such a movement as we have just outlined was a fairly frequent occurence in the money market. One of the functions of gold as the basis of monetary systems is to maintain prices in gold-standard countries at approximately the same level at any given time, and the fulfillment of this function involves the constant movement between the various countries of a quantity of gold which, although very small in comparison with the total stock of gold in use as currency, or as the basis of currency, is nevertheless sufficient to lower the price level in a country where a redundancy of money tends to raise prices above the world level, and to raise the price level in another country where it has become temporarily depressed below the world level. These movements produce the required effect on the currency systems of the countries concerned in various ways according to the particular monetary organization of each country. What we have just tried to describe is the manner in which movements of gold become effective in the particular case of England. Such move-

ments would generally produce little effect outside the discount market because, before their effect had begun to be felt more widely, the outflow of gold would have been checked, and normal conditions restored. Indeed, between countries where an absolutely free gold market prevails any tendency for the price level in any one country to deviate from the general level is adjusted so quickly that the effect of the working of the system is to anticipate and prevent these deviations rather than to counteract them after they have occurred.

Rates and "Booms." If, however, an exceptionally strong boom in trade resulted in a pronounced rise of prices above the world level, a high Bank rate would affect the whole of the country's financial system. It will be remembered that the rate of interest on ordinary bank loans generally moves in sympathy with Bank rate, so that if a high Bank rate were to continue for any length of time, its effects would spread through the whole range of industry and commerce, and the increased cost of the capital required for carrying stocks of goods would result in forced liquidation, which, by lowering the price level would tend to increase the country's exports of goods and so turn the exchanges in our favor. Nor would the effect of the high rate be communicated to trade and industry only through the banks, which deal chiefly with the more liquid kind of capital. The high rate obtainable for short-term loans, by attracting money from the permanent forms of investment, would increase the rate of interest which would have to be offered for this kind of capital as well, so that there would be a general increase in the rates for all forms of capital, thus hastening the return to a lower price level.

Rates and Contractions. Occasions sometimes arose when, although the international monetary outlook was such as to render a contraction of credit and a reduction of lending abroad desirable, funds were for the time being so plentiful that discount and short-loan rates remained at a low level which encouraged borrowers to put forward their bills for discount, and made it probable that the exchanges would move against us. Under such conditions, the Bank of England, although it might appreciate that the abundance of credit must lead ultimately to an export of gold and a consequent period of stringency in the market, was

powerless to effect a contraction of credit by means of a rise in Bank rate because at the moment its rate was not effective, borrowers being able to obtain all the funds they required from the banks at market rate. The Bank's method of dealing with a situation of this kind was to enter the market itself as a borrower at market rate, or as a seller of investments. The sums thus paid to the Bank were in the form of checks on one or other of the London banks, and the result of the payments to the Bank was that its liability to the other banks was decreased — i.e., the bankers' balances were reduced. In order to replenish their balances, the banks would restrict their loans to the market, and in due course the bill brokers would seek accommodation at the Bank of England and would find that the money taken off the market by the Bank could only be re-borrowed at Bank rate. Its official rate having thus been made effective, the Bank of England was in control of the position, and could maintain high rates until it thought the need for them had passed. Bank rate would of course eventually have become effective in any case, as soon as the inflation of credit had induced an export of gold, but by these measures, the Bank was able to anticipate the trend of events, and by itself creating a slight degree of stringency, to save the market from the more violent effects which would have followed an export of gold.

Exceptional Effectiveness of English Bank Rate. The ability of the central bank to control the import and export of gold before the war merely by altering its official rate of discount was peculiar to the United Kingdom. In all other countries, when an export of gold was threatened, or in progress, a rise in the official rate of discount had to be reënforced in varying degrees by other measures, such as a premium on gold withdrawn from the central bank for export. Even in these countries, a rise in Bank rate, provided it produced a general rise in money rates, and assuming that the export of gold reduced the quantity of money in circulation, would ultimately have lowered the country's price level, and, by increasing exports of goods, would have checked the outflow of gold. The effect, however, of the high money rates could only have been felt gradually, and the country's stock of gold might have been seriously depleted in the meantime. Hence the necessity for supplementary measures.

The rapidity with which changes in Bank rate influenced gold movements in the case of England was due to the fact that England was always on balance a creditor to a considerable extent in the international short-loan market, the greater part of these debts arising from the discount of foreign bills in London, and from the acceptance in London of bills on behalf of foreign drawees. As has been mentioned, an export of gold caused the banks to curtail their loans to the bill brokers, and they in turn, owing to the high rate charged for accommodation at the Bank of England, were compelled to restrict their discounting by a rise in rates. The demand in London for foreign currencies for the remittance of the proceeds of foreign bills discounted was consequently decreased, and this tended to turn the exchanges in favor of England. The influence on the exchanges arising from England's position as a lender to foreign countries was reënforced by the popularity of the sterling bill abroad, both as a medium for remittance, and as a short-term investment. A rise in discount rates lowered the price of all bills except those payable at sight, and so increased the foreign demand for sterling while decreasing the London demand for foreign currencies, the result being that a rise in Bank rate was quickly followed by a movement of the exchanges in favor of England.

The Difficulties of the Bill Brokers. It will have been noticed that the position of the bill brokers is a somewhat difficult one. As intermediaries between lenders and borrowers in the short-loan market, they are the medium through which changes in Bank rate produce their effect. Like middlemen dealing in any other commodity, they bear the brunt of the risk of changes in the price of the commodity they handle. The price of money, however, which is their particular stock-in-trade, is governed by a more complex series of factors than that of any other commodity, and the bill brokers have the additional disadvantage of working on an exceptionally small margin of profit. At any given moment, they are carrying a quantity of bills which they have discounted at a certain average rate, and their profit depends entirely on their being able to borrow at a somewhat lower rate sufficient money to carry their stock. Even the smallest unforseen hardening of money rates is sufficient to eliminate their anticipated profit on any transaction, and whenever they are compelled to

borrow from the Bank of England, a loss is certain since the market rate of discount is always below Bank rate.

Bill Brokers and Rates. The difficulty of the bill broker's position is especially noticeable at times when the Bank of England is seeking to raise discount rates in spite of an abundance of funds in the market. At such times, the brokers on the one hand are competing with each other for a number of bills which is hardly sufficient to absorb all the funds at their disposal, while the Bank of England on the other hand is making efforts to cause the banks to reduce their loans and raise their rates. Nor is the lot of the brokers made any easier by the fact that when Bank rate is rising, it is almost invariably increased by steps of 1 per cent, while when the movement is downwards, it is generally by steps of only one-half per cent, with the result that, other things being equal, the losses made by the brokers when Bank rate is rising are greater than the profits made when Bank rate is falling. It must be added, however, that their experience and knowledge of the market enable the brokers to forecast future movements with a good deal of accuracy and, if one can judge from the results of the public companies engaging in this type of business, to earn profits which are fairly commensurate with the useful function they perform in the financial mechanism.

London Bill Brokers. The existence of a group of firms dealing exclusively in bills of exchange is peculiar to the London market. In other countries, holders of bills discount them at the banks without the intervention of a middleman, and so the funds which in England would be lent to the bill market at call or short notice are lent directly to the trading community. Consequently, the banks in these countries, whenever they need to strengthen their cash positions, must rediscount their holdings of bills at their central banks. In London, however, this procedure is not necessary, and the banks never rediscount bills at the Bank of England. What they do is to call in their loans to the bill market, thus compelling the bill brokers to have recourse to the Bank of England. The effect, of course, is the same as in other countries, the only difference being that the money is lent by the central institution to the bill brokers instead of the banks. In either case, the money lent appears in the form of an increase

in the bankers' balances with the central institution, since the sums borrowed from the Bank of England are used by the brokers to repay their loans from other banks, and are paid in by the banks to the credit of their accounts with the Bank of England.

FREQUENCY OF FLUCTUATIONS IN ENGLISH BANK RATE. A feature of the English system which was before the war a subject of frequent discussion was the fact that fluctuations in Bank rate, and therefore in money rates generally, were far more frequent in England than in other countries. This of course was a consequence of the unique position occupied by London as the center of the world's financial mechanism — a position which was based on the widespread nature of England's trade and business connections, and the certainty that anyone who had a claim to receive cash on demand in London could always rely on obtaining payment in gold which would be available for export without let or hindrance. As a result of the popularity of the sterling bill abroad, as a medium both for remittance and investment, London was exposed on all sides to demands for gold which might at any time reach dangerous proportions, and against which Bank rate was the primary weapon of defence, assisted by open market operations. Added to this was the fact that the development of deposit banking had led to an economy of gold which rendered the country's central reserve perilously small in proportion to the enormous structure of credit which was based on it. The frequency of fluctuations in Bank rate therefore was a necessary consequence of the nature of the English banking system, and if the resulting instability of money rates was disadvantageous to industry and trade, it must also be borne in mind that the country reaped great economic benefits from the position occupied by London in world finance, and from the high degree of perfection to which deposit banking had been carried.

Having now sketched in very brief outline the working of the money market before the war, we must proceed to consider the changes brought about by the financial upheaval which followed the outbreak of war in 1914 with a view to understanding the somewhat abnormal conditions which still prevail.

THE MONEY MARKET DURING THE WAR

The Crisis of 1914. The summer of 1914 found the money markets of the world in a condition of weakness in which a much smaller crisis than the one which actually occurred would have sufficed to bring about a serious collapse in credit. Prices had been steadily rising for some years, and with boom conditions prevailing in industry and trade, and especially on the world's chief stock exchanges, credit had been expanded to a degree at which the slightest shock to business confidence was bound to have far-reaching effects. It is not, however, suggested that the disturbance which followed the outbreak of the war was to any appreciable extent due to the weakness of the financial position. The disorganization of international relations was unprecedented in the number of great nations involved and the suddenness and completeness of the rupture between them, and such a political chaos could not fail to react on the world's economic system in a manner which was equally unprecedented, and which no amount of foresight could have averted or even modified.

The financial problems which the United Kingdom was called upon to face may be classified under four headings:

1. The shock to confidence made it probable that there would be a run on the banks which would render the amount of legal tender money inadequate to meet the demands for it.
2. Owing to the disturbance to the foreign exchanges and the severance of diplomatic relationships, the foreign debtors of the London accepting houses (i.e., the parties on whose behalf bills had been accepted in London) were unable to remit funds to London to meet the bills at maturity, with the result that the accepting houses found the greatest difficulty in meeting their obligations.
3. The inability of the acceptors of bills immediately and fully to discharge their liabilities made it impossible for the bill brokers to obtain payment of the bills held at maturity. At the same time, the banks were calling in their loans to the market in order to strengthen their cash positions. As a

result of this combination of circumstances, the discount market was on the verge of collapse.

4. On the Stock Exchange, a large business in foreign securities had been done for foreign clients, who on balance owed the market considerable sums. The dislocation of the foreign exchanges made it impossible for these foreign debtors to remit. Added to this, there was a general depreciation of all types of security, with the possibility that the banks would refuse to renew their loans to the Stock Exchange as they fell due for repayment, and would certainly reduce the amounts in order to keep intact the usual margin between the value of the security and the amount of money advanced. Under these conditions, business could not be carried on in the absence of emergency measures.

Protective Measures. The first of the problems indicated above — that of meeting a general run on the banks — did not prove as serious as had been anticipated. The measures taken to combat this danger, however, proved to be more lasting and far-reaching in their effects than any of the other expedients resorted to during this critical period. The various regulations made for the protection of the discount market and the Stock Exchange were able to be relaxed by gradual steps as conditions became less abnormal, and are now a thing of the past, but the measures adopted for the provision of internal currency and for the protection of the nation's gold reserves continued to exert their influence on the whole financial system of the country throughout the war and for some time after. They are even now still partially in force, and will probably prove to have exercised a permanent effect on the country's financial system. As the arrangements in connection with the currency and the gold reserve are thus of greater importance in relation to the present position of British finance than any of the other emergency measures, we propose to pause for a moment to outline these less important happenings, and then to return to the currency legislation and its bearing on the present position.

Stock Exchange Closed. It was on the 4th August 1914, that war was declared between Great Britain and Germany, three days after Germany had declared war on Russia, and two days after

the outbreak of war between Germany and France. The crisis, however, really began on the 30th July. During the previous week, the course of political events had been causing an increasing degree of alarm. One after another of the continental stock exchanges had been obliged to shut down, and at the close of business on the 30th July, the London Stock Exchange followed their example. This step was rendered necessary by the fact that the foreign exchanges were at a deadlock, and London's foreign debtors were unable to remit. The dislocation of the exchanges was indeed the fundamental difficulty with which Great Britain had to contend, the extreme measures which had to be taken for the protection of British finance being the result not of any weakness in the British system, but rather of the great strength of London in comparison with other countries. Early in the crisis, London began to take advantage of her position as a creditor in the short loan market by calling in credit on all sides. This caused a big demand for sterling bills on the part of foreign debtors, and the supply was soon exhausted. As the remittance of gold was impracticable owing to restrictions on its export from other countries and the difficulties of transport, the foreign exchanges quickly moved in England's favor until sterling stood at a considerable premium in all countries except France, this exception being due to the fact that the Paris banks had large balances in London which they withdrew to strengthen their own position. Rates, however, became purely nominal, business being impossible owing to the lack of bills.

The closing of the Stock Exchange was followed in rapid succession by a series of further protective measures. On the 30th July Bank rate was raised from 3 to 4 per cent, the next day it reached 8 per cent, and on the 1st August it jumped to 10 per cent, as a result of heavy demands for accommodation on the part of the bill brokers. These steps, however, were of little avail as an influx of gold was impossible under the conditions prevailing, and the excessively high rate for money only added to the difficulties of the bill brokers.

Moratoria. The first measure for the protection of the bill market was taken on the 2nd August, when a proclamation was issued which made it legal to postpone the payment of all bills of exchange accepted before the 4th August for one month from the

original date of maturity. This however did not apply to checks, and the postponed bills had to be reaccepted for the original amount plus interest to the new date of payment at the Bank rate current at the date of reacceptance. On the 6th August, the law postponing payment of bills of exchange was supplemented by a more general moratorium authorizing debtors to postpone all payments until the 4th September, with certain exceptions such as sums not exceeding £5, wages and salaries, payments by Government departments, and the encashment of bank notes by the issuing banks. The period of the moratorium was later extended to the 4th November. In order to give time for the preparation of these and other measures, a proclamation was issued declaring the 4th, 5th, and 6th of August Bank Holidays — the 3rd had been a Public Holiday in the normal course.

Effect of Moratoria. The effect of the two moratoria was to save the bill brokers and the accepting houses from the collapse which must otherwise inevitably have resulted from the inability of their foreign debtors to discharge their liabilities, while the money market as a whole was spared the chaos which would have followed a series of bankruptcies in the discount market. With the bill market thus temporarily saved from disaster, and with the additional support of enactments with regard to the currency which had been made in the meantime (and which will be described later), the banks reopened to the public on the 7th August. On the preceding day, Bank rate had been reduced from 10 to 6 per cent, and on the 8th August it was further reduced to 5 per cent. Business was thus restarted, but it was on an artificial basis. The bill market remained at a standstill, and until this could be remedied, there was no possibility of a resumption of foreign exchange business. The foreign exchanges on the other hand could not begin to function until the machinery of the bill market was set in motion.

With a view to terminating this deadlock, it was announced on the 13th August that the Bank of England would discount any approved bill of exchange accepted before the 4th August at any time before its due date at Bank rate without recourse to the holder, and that at the maturity of the bill, the Bank would give the acceptor the opportunity of postponing payment, interest being payable in the meantime at 2 per cent above Bank rate.

" Approved " bills were to include the bills ordinarily discounted by the Bank, good trade bills, and the acceptances of foreign and colonial firms established in Great Britain, and the Government guaranteed the Bank against any loss it might incur in discounting such bills.

Stringency Relieved. The facilities thus given for the discount of bills greatly relieved the stringency in the market, as the financial houses were at once able to rediscount their holdings of bills with the Bank of England, and in this way to increase their liquid resources. They did not, however, assist the foreign exchange market by bringing new bills forward for acceptance because accepting houses were still afraid that funds would not be forthcoming at the maturity of the bills. To remove this difficulty, it was announced on the 5th September that the Bank of England, under Treasury guarantee, would provide acceptors with funds to pay all approved pre-moratorium bills at maturity. The drawers and endorsers of such bills were thus released from their liability, but the acceptors were to collect the funds due to them as soon as possible, and apply the sums collected in the reduction of the advances by the Bank of England, interest being charged on the advances at 2 per cent above Bank rate. The Bank of England undertook not to claim repayment of such advances until one year after the end of the war. It was announced at the same time that the joint stock banks would on similar terms, and with the assistance of the Bank of England and the Government, advance to clients the amounts necessary to pay their acceptances at maturity where the funds had not been furnished by the clients of the acceptor, provided they were satisfied as to the nature of the transaction, and the reason why the money was not forthcoming from the acceptor's clients.

Some weeks later, at the end of October, the Government turned its attention to the Stock Exchange, which was still closed and could not resume business because of the moratorium, which enabled its debtors to postpone payment of the amounts owing, and thus prevented settlements between the members of the market themselves. A scheme for the assistance of the Stock Exchange was formulated whereby the banks which were able to take advantage of the currency measures undertook not to press for repayment of their loans to the Stock Exchange until

a year after the end of the war, nor to demand any increase in the security for such loans. With regard to loans to the Stock Exchange by lenders other than the banks, it was announced that the Bank of England under Government guarantee would advance 60 per cent of such loans at the rate of 1 per cent above Bank rate, and would not press for repayment until one year after the end of the war.

More Normal Conditions Restored. Under the combined operation of these measures there was a gradual return to more normal conditions. The importance of the assistance rendered by the Bank of England under the various Government guarantees is clear from the amounts advanced by the Bank. The total of bills discounted under the guarantee was some £120,000,000, which was probably about one-third of the bills in the market at the outbreak of war. Advances to acceptors to enable them to meet their acceptances at maturity amounted to about £60,000,000, while loans to the Stock Exchange reached the comparatively small figure of £520,000. By the 4th November, it was found possible to terminate the general moratorium, but it was not until the 4th January, 1915, that the Stock Exchange was reopened, and then only under stringent regulations imposed by the Treasury.

The Issue of Currency Notes. We have now to return to the measures taken for the provision of an adequate amount of currency to meet a possible run on the banks. It will be remembered that the currency circulating in England before the war consisted of gold, silver, and copper coin, and Bank of England notes, which beyond the fixed fiduciary issue had to be backed by gold to their full value, the minimum amount for which notes could be issued being £5. There was also a negligible amount of country bank notes, and in Scotland there were bank notes for £1 and upwards, the issue of which, however, could only be expanded against gold to the full value of the increased issues. With no elasticity of note issue, therefore, the legal tender currency could expand only as the result of an import of gold. We have seen that London had had no experience of an intensive run on the banks since the crisis of 1866, so that, apart from the time-honored remedy of suspending the Bank Act, there was no precedent to be followed in dealing with an extensive demand for legal tender money.

FEAR OF A "RUN." When the crisis was reached in 1914, the fear uppermost in the minds of all bankers was that the shock to confidence would cause the public to demand cash for their bank balances to a greater extent than could be met by the amount of legal tender money then available. At an early stage in the crisis, the banks began to call in their loans to the bill market, forcing the bill brokers to borrow heavily from the Bank of England. The loans granted to the brokers by the Bank swelled the bankers' balances with the central institution, and the banks at once drew on these increased balances to replenish their tills. This course of events is reflected very clearly in the returns of the Bank of England dated the 29th July and 5th August, 1914, from which it appears that while the reserve during this period decreased by some £17,000,000, and Other Securities rose by about £18,000,000, Other Deposits (which consist to a large extent of bankers' balances) increased by only £2,250,000. That the fears of a shortage of legal tender money were not without foundation is clear from these figures, and from a letter which the Bank of England addressed to the Chancellor of the Exchequer on the 1st August, stating that during the preceding five days upwards of £27,000,000 had been advanced to banks, bill brokers, and merchants, and that the reserve (which on the 29th July had stood at £26,875,194) would by the close of business on that day (the 1st August) have been reduced to about £11,000,000. It was pointed out in the same letter that although no legitimate application for assistance had so far been refused, it was feared that the Bank must shortly curtail its facilities unless steps were taken to suspend the legal limitation on the fiduciary issue of Bank notes.

In response to this letter, the Government authorized the Bank to issue notes against securities in excess of the maximum allowed by the Bank Act so far as was necessary in discounting bills and advancing on approved securities to meet the wants of legitimate commerce, provided that no such discount or advance was made at a rate of less than 10 per cent. The Bank Act was thus on the evening of Saturday, the 1st August, suspended for the first time since 1866. The following Monday was a Bank Holiday in the ordinary course, and the next three days were declared additional Bank Holidays. This gave time for the formulation of a scheme for the issue of small currency to supplement

the provision already made by the suspension of the Bank Act, which, by itself, did not do anything to meet the need for notes of a lower denomination than £5.

Issue of Small Currency. The small currency was provided by the Currency and Bank Notes Act of the 6th August, 1914 — the most important of the emergency measures if judged by its effect on the financial history of subsequent years. This Act provided for the issue by the Treasury of currency notes for £1 and 10s. which were to be legal tender in the United Kingdom for the payment of any amount, and convertible into gold coin on demand at the Bank of England [11] at their face value. The notes, by the joint operation of the Act and a Treasury Minute of the same date, were to be issued through the Bank of England to bankers as and when required up to a limit not exceeding, in the case of any bank, 20 per cent of its liabilities on deposit and current account, and were to be treated as an advance by the Treasury to the bank concerned, bearing interest at Bank rate, and secured by a floating charge on the assets of each bank up to the amount of notes issued to it. The advances could be repaid at any time, and sums received in repayment were to be applied by the Bank of England in cancelling currency notes returned from circulation. To enable the banks to obtain advances although actual currency might not be required, arrangements were made for the Bank of England to issue certificates in lieu of actual notes. These arrangements applied to Scotland and Ireland as well as to England and Wales, but in the case of the first two countries, the currency notes instead of being issued to the public were to be used by the banks of issue as cover for their own notes. The Act also indemnified the Bank of England in connection with the suspension of the Bank Act which had been authorized on the 1st August. By a further clause of the Act, Postal Orders were made temporarily full legal tender, but this provision was of little importance.

Reopening of Banks. With a ready supply of currency thus assured, the banks were able to reopen on the 7th August without any fears as to their ability to meet demands for cash. In the early stages of the crisis, there had been evidence of a certain demand for gold on the part of the public for hoarding, which was unfor-

[11] This provision for convertibility was not effective, as will be explained later.

tunately encouraged by the action of some of the banks in meeting their liabilities in Bank notes, and refusing to pay out gold. This the banks were fully entitled to do, but their action nevertheless caused a good deal of apprehension, and a considerable number of Bank notes were taken to the Bank of England to be exchanged for gold.

It became obvious, however, soon after the reopening of the banks that the slight lack of confidence in the banking system which had marked the closing days of July had been effectively dispelled. The fiduciary issue of Bank notes authorized by the Bank Act was exceeded on only two days, and by a trifling amount, while the banks availed themselves of the power to obtain advances in the form of currency notes to the extent of only some £13,000,000, although they could if necessary have obtained as much as £225,000,000. Even the small amount actually borrowed was quickly reduced, so that by the end of September the amount outstanding was negligible. This, however, does not mean to say that the measures taken were unnecessary, or even too liberal. On this occasion probably, as in previous financial crises, the fact that currency could be obtained if required was in itself sufficient to make the public refrain from asking for it. If it had not been available, they would almost certainly have wanted it.

Concentration of Gold. Provision having thus been made for a supply of paper money, it was thought desirable that the gold resources of the country, a large proportion of which before the war was circulating as gold coin, should be concentrated in the hands of the banks, both for the sake of the moral effect of a large gold reserve, and in order that the metal might be available for export by the Government, if necessary, to pay for war supplies from abroad. This object was achieved without any legislation, the public being merely asked by the Government to pay in their gold to the banks or post offices, and not to exchange checks or notes for gold. The response to this request was almost universal, and gold soon ceased to circulate, its place being taken by currency notes. The country's gold resources were still further centralized in 1920 when the banks handed over their own holdings of the metal to the Bank of England.

Soon after the commencement of the war, an important change in the method of issuing currency notes came gradually into oper-

ation. When the notes were first issued, the asset held by the Bank of England against the amount issued was the liability of the banks for the loans to them which the issues represented. As the banks had to pay interest on these amounts at Bank rate, they naturally paid off the advances as soon as they found it possible to dispense with assistance in this form.

How Notes were Obtained. Thenceforward, the banks obtained the notes they required by drawing on their accounts at the Bank of England, and the Bank in turn credited the amounts withdrawn to the Currency Note Redemption Account. If the process had stopped at this point, the currency note issue would have been backed by a balance at the Bank of England. This, however, was not the case. Early in the war, various sums of gold were earmarked as a currency note reserve — i.e., these sums were withdrawn in specie from the Currency Note Account and held by the Bank as a reserve against the notes — and this gold was after the war supplemented, and later superseded by a larger amount of Bank notes similarly held. Practically the whole of the remaining balance of the account was then borrowed by the Government, which substituted its own securities for the amounts borrowed, so that the whole of the currency notes outstanding in excess of the earmarked gold or Bank notes represented a loan to the Government. In this way, the Government borrowed free of interest upwards of £300,000,000 from the general public during the war, and of this over £200,000,000 is still outstanding.

The method of issuing the currency notes will be seen from the following specimen of the Currency Note Return, which is published every week:

CURRENCY NOTE ISSUE

BALANCE SHEET — 26TH MAY, 1926

Notes outstanding —	£	Advances —	£
One Pound	237,239,340	Other bankers	———
Ten Shilling	42,964,446	Currency Note Redemption Account —	
Certificates Outstanding	18,760,000	Gold Coin & Bullion .	———
Total	298,963,786	Silver Coin	6,550,000
Notes called in but not yet cancelled	1,304,381	Bank of England Notes	56,250,000
		Government Securities	249,604,425
Investments Reserve Account	12,261,852	Balance at Bank of England	125,594
	312,530,019		312,530,019

The return speaks for itself with the exception of two items — Certificates outstanding, and Investments Reserve Account. The former are the Currency Note Certificates issued under the arrangement already referred to whereby the banks, if they wish to hold cash which will not be required for issue to the public, can obtain it in the form of certificates representing currency notes instead of actually holding notes. This is merely a matter of convenience. The Investments Reserve Account represents interest on the advances which were made at the beginning of the war to the banks, and interest on the Government securities held against the notes. A balance of approximately 5 per cent of the Government securities held against the note issue from time to time is maintained to meet any depreciation in the securities, and amounts in excess of this are transferred to the Exchequer and merged in the general finances of the country.

Inflation. It will be clear from the foregoing that the issue of currency notes, which was commenced with the object of providing a sufficient supply of legal tender money, gradually developed into an instrument of Government finance, for to the extent to which it issued notes against it own securities, the Government was simply financing itself by means of the printing press. This process of course could not continue without involving inflation both of currency and credit, because the country was no longer on an effective gold standard.

This statement that the gold standard had been abandoned may appear surprising in view of the fact that the Currency and Bank Notes Act provided for the convertibility of the currency notes into gold at the Bank of England, for there was until 1925 no modification of this provision, and it might therefore appear that the gold standard was maintained in force throughout the war. This was far from being the case. Although the notes were convertible, there soon ceased to be any object in withdrawing gold from the Bank for export because the greatly increased expense of insuring and transporting the metal placed the gold export points very much below their normal level, and none of the foreign exchange rates actually moved below these points, although, in the case of the United States of America, the rate was kept above the new gold export point only by the aid of exports of gold on Government account, and artificial measures

such as enforced sales of British-held dollar securities, and the raising of credits in the United States.

Melting of Gold Illegal. With the private export of the metal thus precluded, partly by the expense of transport, and partly by artificial support of exchange rates, there was nevertheless a possibility that gold coin might be withdrawn from the Bank for melting and sale within the country, to take advantage of the rise in its price — there still being a market in the metal because newly mined gold could be exported under licence. To combat this, at an early stage in the war, the melting of gold coins was made illegal, and to complete the conservation of the nation's gold resources, it was provided that gold bullion should be imported into the country only by the Bank of England. For all practical purposes, therefore, the paper currency was inconvertible, and the gold standard was definitely abandoned, although gold was exported from time to time on Government account.

Inflation and Prices. In these circumstances, the export of gold which would normally follow a rise in prices, and so check inflation, could not take place, and the process of inflation and rising prices was free to continue so long as it did not depress exchange rates below the new and abnormally low gold export points, a result which was not likely to occur in view of the fact that the exchanges were supported by artificial means. The expansion in the currency note issue, however, must not be regarded by itself as the cause of the great rise in prices which took place during the war period. The primary factor was the expansion of credit resulting from Government borrowing, which took the form both of more or less long-dated loans, and of short-term loans in the shape of Ways and Means Advances, Treasury Bills, and loans from the banks. The manner in which Government borrowing to finance the war led to an expansion of credit, with a parallel increase in the currency note issue, is very clearly described in the following extracts from the Report of the Cunliffe Committee:

> "Suppose, for example, that in a given week, the Government require £10,000,000 over and above the receipts from taxation and loans from the public. They apply for an ad-

vance from the Bank of England, which by a book entry places the amount required to the credit of Public Deposits in the same way as any other banker credits the account of a customer when he grants him temporary accommodation. The amount is then paid out to contractors and other Government creditors, and passes, when the checks are cleared, to the credit of their bankers in the books of the Bank of England — in other words is transferred from Public to 'Other' Deposits, the effect of the whole transaction thus being to increase by £10,000,000 the purchasing power in the hands of the public in the form of deposits in the Joint Stock Banks and the bankers' cash at the Bank of England by the same amount. The bankers' liabilities to depositors having thus increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war something under 20 per cent) is improved, with the result that they are in a position to make advances to their customers to an amount equal to four or five times the sum added to their cash reserves, or, in the absence of demand for such accommodation, to increase their investments by the difference between the cash received and the proportion they require to hold against the increase of their deposit liabilities. Since the outbreak of war, it is the second procedure which has in the main been followed, the surplus cash having been used to subscribe for Treasury Bills and other Government securities. The money so subscribed has again been spent by the Government and returned in the manner above described to the bankers' cash balances, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits representing new purchasing power to several times that amount. Before the war these processes, if continued, compelled the Bank of England to raise its rate of discount, but, as indicated below, the unlimited issue of Currency Notes has now removed this check upon the continued expansion of credit."

"The greatly increased volume of bank deposits, representing a corresponding increase of purchasing power and, therefore, leading in conjunction with other causes to a great

> rise of prices, has brought about a corresponding demand for legal tender currency which could not have been satisfied under the stringent provisions of the Act of 1844. Contractors are obliged to draw checks against their accounts in order to discharge their wages bill — itself enhanced on account of the rise of prices. It is to provide this currency that the continually growing issues of Currency Notes have been made." [12]

The tendency to inflation was further accentuated by the arrangements made by the banks for granting advances to their customers to enable the latter to subscribe to long-term Government loans, this process being encouraged by the banks at the instigation of the Government.

Process of Expansion. The space at our disposal does not permit of any detailed analysis of the process of credit expansion, but the table at the top of the next page will serve to show roughly the extent of the disturbance to the country's financial system which resulted from the monetary and economic difficulties of the war period.

Rate Influence Lost. One of the most important consequences of the abandonment of the gold standard was that Bank rate lost its normal influence on the money market. As the leader of the discount market, the primary function of a central bank is, as far as possible, to maintain stability of prices by controlling the movement of gold to and from the country. This the Bank of England could no longer do after there had ceased to be a free gold market and a definite connection between the volume of gold and the volume of currency in the country. At the same time Bank rate was robbed of its influence even on domestic finance by the predominating position which the Government assumed in the money market. The Government's operations, both as a borrower, and as a provider of currency, completely dwarfed those of the other constituents of the market, and the Government necessarily became a financial dictator. Apart from the successive loans in more or less permanent form which were raised at gradually rising rates of interest, the chief instruments

[12] First Interim Report of the Committee on Currency and Foreign Exchanges after the War. Paragraph 10 (footnote) and paragraph 11.

End of	Floating Debt Outstanding	Fiduciary Currency Note Issue	Total of British Bank Deposits [13]	Commodity Price Index Number [14]
	£	£	£	
1913	23,000,000	....	1,142,038,000	100
1914	105,390,000	19,978,000	1,322,267,000	100
1915	465,611,500	74,625,000	1,433,374,000	127.1
1916	1,286,847,000	121,644,000	1,657,705,000	159.5
1917	1,360,517,000	184,282,000	1,909,083,000	206.1
1918	1,549,922,000	294,741,000	2,274,729,000	226.5
1919	1,349,324,000	323,652,000	2,598,695,000	241.9
1920	1,408,081,000	319,676,000	2,739,155,000	295.3
1921	1,259,840,000	277,634,000	2,699,068,000	182.4
1922	941,051,500	253,186,000	2,553,147,000	154.1
1923	860,452,500	249,620,000	2,486,153,000	151.8
1924	845,825,000	242,431,000	2,510,291,000	164.6
1925	816,641,000	240,527,000	2,490,054,000	159.5

This table should not be regarded as an exact index to the monetary and financial position during the period covered. It is intended merely as a rough illustration of the changes brought about by war and post-war financing.

of Government borrowing were Ways and Means Advances from the Bank of England, Treasury bills, and loans of bankers' spare balances which were arranged through the Bank of England. The rates which the Government had to pay on such loans were the minimum rates necessary to ensure that the amounts required from time to time would be forthcoming, and these automatically became the minimum market rates for short-term money. There was a steady rise in interest rates throughout the war, but this was less pronounced than it would otherwise have been owing to the fact that the Government, although it was a heavy borrower, was at the same time creating credit in the manner described in the extract from the Report of the Cunliffe Committee given above.

The New York-London Exchange. In the foreign exchange market during and after the war, the chief interest centered in the rate on New York. The price of the dollar was an important factor while the war continued because the United States was the chief source of war supplies, and later, when the question of re-

[13] "Statist," British Banking Section, 29th May, 1926, p. 873.

[14] "Statist" Index Number of wholesale prices, yearly averages.

establishing monetary stability in Europe came to be considered, the dollar was regarded with equal interest because New York was the only important free gold market and held by far the greater part of the world's supply of gold.

When the war crisis began, the New York exchange moved sharply in favor of London, owing to the demand for sterling in New York to meet obligations in London, a demand which could not be met because there were not sufficient trade bills forthcoming, and there was a general unwillingness to create finance bills. This, however, proved to be only a temporary phase, and when the available foreign exchange mechanism had been restored to working order, the rate moved gradually in favor of New York. In spite of British Government exports of gold and securities, the rate in September, 1915, touched the low point of 4.47. After this, there was a recovery until January, 1916, when the American Dollar Securities Committee began operations. From this point until March, 1919, the rate was maintained in the region of 4.76 by means of the mobilization and export of foreign securities on a very large scale, the raising of loans in the United States, and further exports of gold. The difficulties of supporting the exchange were increased by the granting of loans by the United Kingdom to the Allies, a large part of these loans being used to purchase commodities in the United States.

"Pegging" Ended. In March, 1919, the Government support of the dollar exchange was removed and the unpegging of the rate was followed by a rapid depreciation in sterling. It was clear that as soon as the dollar-sterling rate was left free to reflect economic and monetary conditions, the much higher price level prevailing in the United Kingdom as compared with the United States must quickly cause the exchange rate to fall below the gold export point. This would have led to heavy withdrawals of gold from the Bank for export. So long, however, as there was no causal connection between the gold reserve and the volume of credit and currency, exports of gold could have no influence on the price level, and therefore could not bring about any permanent improvement in the position. Moreover, any depletion of the nation's gold resources would have made the problem of the ultimate return to the gold standard much more difficult. In such circumstances, the only possible course was to make the

export of gold illegal, and this was done by an Order in Council of the 1st April, 1919.

This regulation was in December, 1920, embodied in an Act of Parliament[15] which provided for the continuance of the prohibition on the export of gold coin and bullion and the melting of gold coin until the 31st December, 1925. From March, 1919, onwards, in the absence of artificial support, and as the result mainly of continued inflation in England, the value of the £ sterling continued to fall, the rate on New York touching its lowest point — about 3.20 — on the 4th February, 1920.

THE MONEY MARKET AFTER THE WAR

THE PROBLEM OF RESTORING THE GOLD STANDARD. The close of the war, therefore, was not followed by any immediate improvement in the country's financial position. There was indeed until 1920 a continued deterioration, due mainly to the fact that it was not found possible at once to stop Government borrowing. With national expenditure still on a huge scale, the expansion of Ways and Means Advances, and the growth in the amount of Treasury bills outstanding continued, and were reflected in a further inflation of credit and currency, accentuated by the boom in trade which followed the war. The floating debt reached its highest point in June 1919, but it was not until the Spring of 1920 that the real turning point came with the general collapse in prices which ended the trade boom.

The problem of returning to more normal conditions which presented itself in 1920 was a very difficult one. The pre-war currency of gold and Bank notes (which were practically the equivalent of gold) had been replaced by a mass of virtually inconvertible paper money subject to no limitations of issue, and bearing no definite relation to the needs of commerce, and as a result chiefly of this development, Bank rate had lost its former influence over the country's credit system. There could be no return to monetary stability until the essentials of the gold standard were restored — i.e., until arrangements were once more in force whereby the volume of credit and currency would be regu-

[15] Gold and Silver (Export Control, etc.) Act, 1920.

lated by movements of gold, which in turn would be controlled by the Bank of England as the leader of the discount market, through the medium of Bank rate. That a good deal of ground would have to be covered before such conditions could be reestablished was evident from the substantial discount on sterling in New York.

THE CUNLIFFE COMMITTEE. The difficulties which would arise were realized even before the end of the war, and early in 1918 a Committee (subsequently known as the Cunliffe Committee) was appointed "to consider the various problems which will arise in connection with currency and the foreign exchanges during the period of reconstruction, and report upon the steps required to bring about the restoration of normal conditions in due course, and to consider the working of the Bank Act, 1844, and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear . . . necessary or desirable."

This Committee in August, 1918, issued an interim report [16] in which it reviewed the changes in the financial system caused by the war, and indicated the lines which should be followed during the reconstruction period. They recommended that after the war the conditions necessary for the maintenance of an effective gold standard should be restored without delay, the pre-requisites being:

(a) The cessation of Government borrowing as soon as possible after the war, and the provision of a sinking fund for the reduction of the national debt, more especially the floating debt.

(b) The pre-war machinery which operated to check a foreign drain of gold and the speculative expansion of credit — namely the effective raising of Bank rate — must be restored to working order.

(c) The fiduciary issue of notes should as soon as practicable be again limited by law, and the present arrangements under which the deposits of the Bank of England could be exchanged for legal tender currency without affecting

[16] First Interim Report of the Committee on Currency and Foreign Exchanges after the War. 1918. Cd. 9182.

the reserve of the Banking Department should be terminated at the earliest possible moment. The note issue should ultimately be placed entirely in the hands of the Bank of England.

With regard to the control of the note issue, the Committee made the following observations:

(1) Although Bank of England and currency notes should be convertible into gold on demand, it was not necessary or desirable that there should be any early resumption of the internal circulation of gold coin.
(2) While the import of gold should be free from all restrictions, it was convenient that the Bank of England should have cognizance of all gold exports, and the export of gold should therefore be subject to the condition that such gold should be obtained from the Bank of England for the purpose.
(3) The gold reserves of the country should be held by one central institution, and all banks should transfer any gold then held by them to the Bank of England.

Question of Bank Charter Change. The Committee considered the desirability of modifying the Bank Charter Act so as to give elasticity to the note issue, but decided that no departure should be made from the principle of the fixed fiduciary issue beyond which notes could only be issued in exchange for gold. It was, however, recommended that the section of the Currency and Bank Notes Act of 1914 which authorized temporary issues against securities in excess of the legal maximum should be kept in force, although the Bank should be allowed to act on it only with the consent of the Treasury, and provided that Bank rate was high enough to ensure the earliest possible return to the legal limit.

It was also recommended that the minimum central gold reserve to be aimed at should be £150,000,000 and that the fiduciary issue should be fixed at such amount as experience proved could be kept in circulation without causing the central reserve to fall below that figure.

It was further suggested that as soon as it was found possible to begin reducing the fiduciary issue of currency notes, the actual maximum fiduciary issue in any year should become the legal maximum for the following year.

Deflation. It will be seen that in effect the Committee recommended the restoration of the pre-war system as far as was compatible with the altered conditions, and subsequent developments have been largely on the lines they indicated. As a result, however, of the continuance of credit and currency inflation after the war, it was not until December, 1919, that the first step could be taken in the direction recommended. In that month the Committee issued their Final Report,[17] in which they recommended that effect should be given to the suggestion made in their Interim Report, that as soon as a reduction in the fiduciary note issue was found possible, the actual maximum fiduciary issue for any one year should become the legal maximum for the following year. The Treasury at once acted on the recommendation and this step, although it did nothing to hasten the deflationary movement, at least ensured that there could be no further increase in the fiduciary issue and, that if in any year a contraction in the circulation was found possible, it would be lasting, and could not be counteracted in the following year by a further increase.

End of Trade Boom. There has actually been a reduction in the fiduciary issue of currency notes each year since 1919, but it cannot be said that this has been due to any great extent to the limitation recommended by the Cunliffe Committee, for in the Spring of 1920 the financial system became subject to the much more drastic influence of the sudden collapse of the post-war trade boom. In the Spring of 1920, the inflationary movement and abnormal trade activity which had prevailed in the United Kingdom as in all other countries since the war were suddenly checked by the fall in prices which spread from America to this country. The movement in the United Kingdom was accompanied (perhaps, to some extent, accentuated) by a rise in discount rates under the lead of the Bank of England, and this policy was supported by the voluntary action of the banks in restricting loans for speculative purposes, with a view to ensuring

[17] Final Report of the Committee on Currency and Foreign Exchanges after the War. 1919. Cmd. 464.

as far as possible that accommodation furnished by them should be used only for the purposes of legitimate commerce. The trade depression which followed has been long and severe, for various reasons connected perhaps more closely with economic conditions in Europe than with monetary policy.

Gradual Contraction. The collapse did not produce any rapid effect on the volume of currency and credit, and at the end of 1920 the fiduciary note issue showed no appreciable decrease on the figure for the end of the previous year, while the volume of bank deposits actually showed a considerable expansion. This was due partly to the lag between wholesale and retail prices and wages, partly to frozen bank loans, and partly to the fact that it was not found possible to check the increase in the floating debt. In the next year, however, the deflationary tendency became more pronounced and there was from then onwards steady progress towards a gold basis, as will be seen from the figures given on page 1213.

The year 1921 also marked the beginning of the improvement in the value of the £ sterling in New York. This of course was a very material factor in the financial rehabilitation of the United Kingdom, for unless the £ was to be devalued, the return of the New York exchange to a point somewhere near gold parity was an essential preliminary to the restoration of a free gold market. The return to parity was assisted in no small measure by the accumulation of gold in New York which resulted from the post-war distribution of international indebtedness, and led to a slight rise of prices in the United States between 1921 and 1925 while prices in England were falling. A further source of strength was the funding of the British debt to America in 1923 which did much to restore British credit besides freeing the exchange position from the uncertainty caused by the existence of such a large amount of unfunded international debt.

The Return to the Gold Standard. It will be remembered that the embargo placed on the export of gold by the Gold and Silver (Export Control, etc.) Act of 1920 was to last for five years which would expire on the 31st December, 1925. In anticipation no doubt of the expiry of the Act, which would necessitate a reconsideration of the country's monetary policy, the Treasury, in June, 1924, appointed a Committee " to consider whether the time

has now come to amalgamate the Treasury Note Issue with the Bank of England Note Issue, and, if so, on what terms and conditions the amalgamation should be carried out." The terms of reference, however, do not fully indicate the scope of the Committee's deliberations, for it also considered and reported on the general problem of how and when the return to the gold standard should be made, and its recommendations in this direction were subsequently adopted.

The Report of the Committee [18] is dated February 5, 1925, but it was not published until after the announcement of the restoration of the gold standard. Its most important recommendation is contained in paragraph 23, which reads as follows:

> "We therefore recommend that the early return to the gold basis should forthwith be declared to be the irrevocable policy of His Majesty's Government, and that it should be definitely stated that the existing restrictions on the export of gold, which expire on the 31st December next, will not be renewed. A general licence should at the same time be given to export gold sold by the Bank for export, and the Bank should between now and the date of expiry of the export prohibition avail themselves freely of it whenever the exchange is below the normal export specie point, making good any consequential drafts upon the reserve in the Banking Department in accordance with traditional practice. As from the date of the announcement until such time as the arrangements governing the fiduciary issue can be put on a permanent basis, the existing limitation of that issue should be strictly maintained."

On the question of the note issues, the Committee confirmed the recommendation of the Cunliffe Committee that no steps for the transfer of the currency note issue to the Bank of England should be taken until sufficient experience of the working of the free gold market with a gold stock of £150,000,000 had been obtained to enable the amount of the fiduciary issue to be fixed in conformity with the new conditions.

[18] Report of the Committee on the Currency and Bank of England Note Issues. 1925. Cmd. 2393.

RETURN TO GOLD ANNOUNCED. The announcement of the immediate return to the gold standard was made by the Chancellor of the Exchequer in the course of the Budget Statement on the 28th April, 1925, and the necessary legislation was embodied in the Gold Standard Act of 1925 which received the Royal Assent some days later. The time was, as the Committee had pointed out, an opportune one for this further step in the return to normal conditions, for the New York exchange, aided no doubt by general anticipation of the early restoration of the free gold market, had improved to within 1½ per cent of gold parity. The Committee were however careful to point out that even this slight discount on the £ sterling would involve "a fall in the price level here of a significant, though not very large, amount"[19] before the position would be secure, and their anticipation in this direction has since been fully realized.

During 1924 and 1925, with a view to lessening the pressure on the London-New York exchange, an unofficial embargo had been placed on the flotation of foreign loans in London. This measure had no legal sanction, the restriction on lending abroad being effected merely through coöperation to this end between the big banks and issue houses under the unofficial leadership of the Bank of England, and at the instigation of the Government. After the restoration of the free gold market it was recognized that this policy was no longer necessary or desirable, and the embargo was brought to an end in November, 1925.

THE PRESENT POSITION. As a result of the combined operation of the Gold Standard Act and previous enactments which are still in force, the present position of the monetary system is briefly as follows:

The Bank of England is obliged to buy all gold bullion offered to it at the price of £3. 17. 9. per standard ounce (i.e., 11/12ths fine), the same price as prevailed before the war, and to pay out gold in the form of bars containing approximately 400 ounces of fine gold in exchange for all forms of legal tender money (i.e., Bank of England notes, currency notes and gold coin) at the rate of £3. 17. 10½. per standard ounce (i.e., £4. 4. 11¾. per fine ounce). The recipient of the gold bars is of course free to export them or otherwise deal with them as he wishes.

[19] Paragraph 19.

Only the Bank of England, however, can demand to have gold bullion made into coin at the Mint, in contrast to the pre-war position when everyone could demand this right at the rate of £3. 17. 10½. per standard ounce, and the Bank of England is no longer obliged to pay out gold coin in exchange for Bank notes and currency notes. This means that although such gold coins as are still in circulation remain legal tender, no more gold coins will for the present be issued, and the legal tender money of the country will consist entirely of Bank and currency notes since the amount of gold coins still in the hands of the public is negligible. This measure follows the opinion expressed by the Committee on the Currency and Bank of England Note Issues that "gold for domestic circulation is a luxury that can well be dispensed with, and which we are in fact, at any rate during the next few years, not likely to be able to afford."[20] The various Scotch and Irish bank notes still circulate in those countries.

Amount of Fiduciary Notes. Although no definite steps have yet been taken for fixing the amount of the fiduciary currency note issue, this is still subject to the limitation placed on it as a result of the recommendation of the Cunliffe Committee (i.e., the actual maximum fiduciary issue in any one year becomes the legal maximum for the following year) and there is therefore no danger of inflation which would lead to a rise in prices, followed by an adverse trade balance, and a large export of gold. Gold exports, moreover, result in a fall in the ratio of the Bank's reserve to liabilities, and any serious tendency in this direction can be corrected by the traditional method of turning the foreign exchanges in favor of England — a rise in Bank rate.

The whole of the country's gold reserve is now concentrated at the Bank of England, the gold formerly held for the Currency Note Redemption Account having been transferred to the Bank in exchange for Bank notes at the time of the return to the gold standard.

Exchange Maintained. Since the free gold market was restored, a little over a year ago, no serious difficulty has been experienced in maintaining the New York exchange above the gold export point. Between April, 1925, and the end of May, 1926, the

[20] Paragraph 43.

net amount of gold withdrawn from the Issue Department of the Bank of England was only a little over £6,000,000, and at no time during this period was the net loss as much as £12,000,000. Trade has, however, been consistently depressed, as a result partly of the fall in British prices. At the time of the return to the gold standard, the British Government, by way of precaution, arranged for the right to draw if necessary for a large amount on New York, but this credit does not appear to have been utilized.

THE AMALGAMATION OF THE NOTE ISSUES. The most difficult obstacles to the reconstruction of the financial system having thus been successfully overcome, only the final step — the transfer of the currency note issue to the Bank of England — remains to be taken. This, of course, will result in the reëstablishment of a definite relationship between the volume of legal tender currency in circulation, and the total amount of gold held in the country for monetary purposes.

In this connection, the Cunliffe Committee recommended that "the normal minimum of the central gold reserve to be aimed at should be, in the first instance, £150,000,000," [21] and that the fiduciary note issue should be fixed at an amount which experience shows to be consistent with the maintenance of the reserve at this figure — that is to say, that after the restoration of the free gold market, there should be a period of experiment during which it could be ascertained what amount of currency notes could be kept in circulation without causing the reserve to vary much from £150,000,000. During this period, any excess of notes would cause the price level in England to rise above that of other countries with free gold markets, and would result in an export of gold followed by a contraction of credit and a reduction of the note issue, while if the note issue were reduced too much, lower prices would cause an influx of gold followed by an expansion of credit and an increase in the note issue. When the volume of paper currency compatible with the maintenance of a gold reserve of £150,000,000 had thus been discovered, the fiduciary issue was to be fixed at the difference between this figure and £150,000,000, and thenceforward the amount liable to fluctuation

[21] Interim Report of the Committee on Currency and Foreign Exchanges after the War, paragraph 47.

would be that of notes issued against gold, and not the fiduciary portion. This would also be the time for transferring the currency note issue to the Bank of England.

Fixing the Note Volume. The Committee on the Currency and Bank of England Note Issues confirmed these recommendations and anticipated that " if the free gold market is restored at the end of 1925, the experience necessary to enable the amount of the fiduciary issue to be definitely fixed will have been obtained by the end of 1927." [22] They added, however, that it might well be possible to accelerate these dates in the light of experience, and as the free gold market was actually restored as early as April, 1925, it seems likely that this anticipation will be realized.

The amalgamation of the note issues, when the time comes, can be effected with no disturbance to the existing financial arrangements, except of course that the present currency note issue will have to be withdrawn over a period, and Bank of England notes substituted. In the way of legislation, all that will be required will be the repeal of the relevant part of the Currency and Bank Notes Act of 1914, and an amendment of the Bank Act of 1826 and the Bank Charter Act of 1844 to provide for the increase in the fiduciary issue, and to enable the Bank of England to issue notes of £1 and 10s. (The Bank is at present precluded from issuing notes of a lower denomination than £5.)

When this has been done, the Currency Note Returns will cease to be published, and the whole position with regard to the nation's currency will be embodied in the weekly return of the Bank of England, which will probably continue to be published in its present form in accordance with the recommendation of the Cunliffe Committee. In order to illustrate roughly the proportions which the Bank return may be expected to assume after the currency note issue has been transferred to the Bank of England, there is given below an imaginary Bank Return for the 26th May, 1926, based on the actual Bank Return for that week shown on pp. 1152–3, and the Currency Note Return for the same date shown on p. 1208. If the figures shown in those two returns are

[22] Report of the Committee on the Currency and Bank of England Note Issues, paragraph 50.

consolidated, on the assumption that the note issues have been amalgamated, the result is as follows: [23]

ISSUE DEPARTMENT

	£		£
Notes Issued	411,469,388	Government Debt	254,907,673
		Other Securities	8,734,900
		Gold Coin and Bullion .	147,826,815
		Silver Bullion	——
	411,469,388		411,469,388

BANKING DEPARTMENT

	£		£
Proprietors' Capital ...	14,553,000	Government Securities .	41,035,328
Rest	3,208,423	Other Securities	71,816,648
Public Deposits	20,094,705	Notes	26,869,291
Other Deposits	103,041,828	Gold and Silver Coin ..	1,180,576
7-Day and Other Bills ..	3,887		
	140,901,843		140,901,843

THE MARKET FOR FIXED CAPITAL

Distinction Between Short-term and Fixed Capital. We have now to consider the mechanism which exists in the United Kingdom for providing industry with fixed as opposed to floating or short-term capital. The latter type of accommodation is furnished by the various institutions whose activities in the money market have already been described. The provision of fixed capital, however, is left to a separate section of the market, for under the British system, a sharp distinction is drawn between these two functions of banking and finance.

In dealing with any other European country, industrial finance would naturally fall to be considered under the general heading of banking, for in these countries, and above all in Germany, the banks regard the manufacture and marketing of industrial securities and even the control and management of industrial enterprises as a legitimate and important part of their business. The

[23] This consolidated balance sheet has been drawn up on the lines suggested in an article entitled "The Amalgamation of the Note Issues" in the Monthly Review of the Midland Bank Limited, September–October, 1925. The consolidation actually took place on November 22, 1928.

British banks, however, work on a much smaller proportion of capital to total liabilities than is generally the case on the Continent, and the fact that they are thus so largely using other people's money, in conjunction with the small proportion of cash held against demand liabilities, makes it imperative that liquidity should be their first consideration in utilizing their resources. While, therefore, the German banks are always ready themselves, either alone or in partnership with other financial houses, to furnish the capital required for any sound business proposition, in due course placing the securities with clients who require investments, the English banks confine themselves as regards the financing of industry to the provision of the floating capital required to carry goods in the various stages between raw material and finished article, thus ensuring the maximum liquidity of resources.

Growth of Business Unit. The growth in the size of the industrial unit in recent years has resulted in a corresponding development in joint stock enterprise, and by far the greater part of the country's industry is now conducted on this basis. A large number, however, of the companies floated every year are small private companies which do not invite subscriptions from the general public. Even those securities which are intended ultimately to be held by the public are not always issued directly to it, being often placed privately by an issue house or by the company itself with financial houses who gradually dispose of them to the investing public through the medium of the Stock Exchange. When securities are issued in this way, the Committee of the Stock Exchange, before giving permission to deal in them, requires that certain details of the issue shall be advertised. This advertisement takes the place of the prospectus which is circulated when a public issue is made, but the requirements of the Stock Exchange Committee in this connection are not so comprehensive as those of the Companies Acts relating to prospectuses. Securities which have been taken up by an issue house are also frequently passed on to the public by means of an advertised "Offer for Sale." This, too, is a less satisfactory method than direct issue to the public as the legal stipulations regarding prospectuses do not apply to offers for sale.

Instruments of Investment. In connection with govern-

ment loans and the stocks of public bodies in general, there are in use three methods of evidencing ownership. Under the first method, the stock is entered under the names of the owners in books kept for this purpose by the borrower, or, more commonly, by a bank on its behalf, and when the owner desires to transfer the stock into the name of another person, he must either attend at the place where the register is kept and sign the book, or he must appoint an attorney to do this for him. The latter is the procedure almost invariably followed and the attorney is generally a stockbroker. When stock is acquired in this way, the new holder receives from the seller a receipt for the purchase money. This, however, is nothing more than a memorandum that the transaction has been carried through and need not be produced on the occasion of a subsequent sale. The investor, therefore, does not hold anything which can be described as an instrument of title, although he can at any time obtain confirmation of his holding from the registrar of the stock. Stock transferable in this way is called " Inscribed Stock."

Under the second method of registration, the holder of stock is given a formal certificate to the effect that the stock stands in his name in the register, and when it is desired to transfer a holding of this kind, a transfer deed must be executed by the transferor and transferee, and lodged with the registrar together with the stock certificate, a new certificate being issued to the transferee in due course. Stock dealt with in this way is known as " Registered Stock."

Under the third method, bearer bonds are issued, with coupons for interest payments attached, and no register is kept, the bonds being negotiable by mere delivery.

As regards industrial finance, the investment instruments by which joint stock companies obtain their capital, using the term in the broad sense, may be divided into two classes — those which give the holders joint ownership in the business, and those which make the holders creditors of the company. From the economist's point of view moneys raised by either method are capital, but from the accounting and legal standpoint only that part of the company's securities which makes the holders owners of the business is regarded as capital, money obtained on any other basis being merely a loan to the company.

The capital of a company (giving the word " capital " its legal meaning) is frequently divided into two or more classes, one having preferential rights over the company's assets in the event of a liquidation coupled generally with the right to a certain limited rate of dividend before any profits are distributed to the other class.

Stocks and Shares. Capital is held in the form either of stock which is transferable in multiples of a minimum amount usually fixed by the Articles of Association of the company, or of shares of various denominations, the most common being one pound. The preferential capital is called " preference " or " preferred " stock or shares. This type of capital is frequently entitled, if the company is unable to pay the fixed rate of dividend in any year, to receive arrears of dividend out of the profits of subsequent years before any dividend is paid on the residual capital. It is then called " cumulative." The preferential capital has sometimes the additional right of sharing in profits beyond its fixed rate of dividend after a certain rate has been paid on the residual capital. Stock or shares enjoying this right are known as " participating preference " stock or shares.

The residual capital is described as " ordinary " or " deferred " stock or shares. It is of course this class which stands to gain or lose most from variations in the fortunes of the business, and for this reason the holders frequently have a larger voting power in proportion to the amount of capital held than any other class.

Debentures. The instrument under which companies obtain capital by means of loans from investors who become creditors of the company (as distinct from obtaining subscriptions from persons who, by subscribing, become joint proprietors of the business) is, in the United Kingdom, almost universally the debenture. The security when money is raised in this way may be either an ordinary debenture, under which the lender ranks as a general creditor of the company, or a mortgage debenture, in which case certain specified property of the company is mortgaged to trustees on behalf of the debenture holders, or alternatively the holders may be given the security of a floating charge on the general assets of the company. Debentures may be irredeemable or redeemable. In the latter case, provision is generally made for redemption by means of a sinking fund. The instru-

ment itself may be either a debenture to bearer, a debenture the holder of which is registered in the company's books, or a certificate stating that the holder is registered in the company's books as the proprietor of a certain amount of the total issue.

The holding of capital in the form of stock or shares is evidenced by a certificate to the effect that the person named is registered in the company's books as the holder of so much stock or so many shares. When it is desired to transfer either debenture capital (with the exception of debentures to bearer) or stock or shares, a transfer deed must be executed by both the transferor and transferee, stamped in accordance with the amount of the consideration money, and lodged at the company's office, together with the relative stock or share certificate. A new certificate is then issued to the transferee. It need hardly be said that the different kinds of share and loan capital are employed in various combinations in the form thought most suitable for the company's particular requirements or dictated by the affairs of the company in relation to conditions in the capital market.

The mobilization of capital in the United Kingdom for Government or municipal purposes, or for joint stock companies, is effected in four different ways — either by an issue house, through the activities of the company promoter, by means of a direct appeal for capital by the borrower to the public, or through the medium of the investment trust company.

The Issue House. In dealing with the structure of the money market, mention was made of a group of institutions known as merchant bankers. The operations of these firms are not confined to the bill market, for they also concern themselves with the provision of fixed capital, and in company with a few other firms which specialize in investment business, they form the group known as the issue houses. The members of this group undertake the whole process of placing an issue with the public, either buying the securities outright from the borrower, and making their profit by selling them at a higher price to the public, or working on a commission basis by which they undertake to find the whole of the capital required in return for a commission on the amount involved.

Standing of Houses. The London issue houses, with a few exceptions, are firms of high standing, and in order to maintain

their reputation for being associated with only the best class of security, they are accustomed to investigate very closely any proposition which is put before them to ensure that it has a reasonable prospect of financial success. For this purpose, they employ technical experts such as accountants and engineers, and the close contact thus established between issue house and borrower is of advantage to each party, for not only is the reputation of the issue house safeguarded, but the borrowing institution often profits by suggestions of the issue house for the better conduct of its business.

It must not, however, be supposed that the issue houses are directly connected to any large extent with British industry. On the contrary, their main associations are with foreign and colonial governments and municipalities, and municipal undertakings in the United Kingdom, and as far as home borrowing is concerned they prefer to deal primarily with public bodies or large and well established industrial undertakings. This means that an issue house rarely assists in the flotation of a new company, and even its services to companies already established are restricted to the better known firms. These are precisely the companies which are best able to raise capital by means of a direct appeal to the public, so that the utility of the issue house to home industry is very limited.

There are many people who take the view that British industry is handicapped in competing with other countries by the lack of adequate financial arrangements, and that it would be of great advantage if the issue houses were to give more attention to the needs of home industry. If this could be done, British companies would not only benefit from the facilities at the disposal of the issue houses for ensuring that their businesses should be started on sound lines, but would also be able to obtain capital on more advantageous terms as a result of the prestige arising from their association with a reputable issue house. Under present conditions, the flotation of companies is left too largely in the hands of the company promoter, whose activities must now be briefly described.

The Company Promoter. The first requirement of the person or small firm with a business project to develop is generally an adequate amount of capital. Where to obtain this in the

United Kingdom is a difficult problem, for the provision of capital in such a case is quite outside the province of a British bank, while the issue houses do not concern themselves with the flotation of small companies. A large number of such companies are launched privately, but where the capital required is larger than can be obtained in this way, other means must be found. In such circumstances, recourse is usually had to the company promoters, who, working individually, or in groups, make a practice of buying businesses or business propositions, and reselling them at a profit to companies floated by themselves for the purpose, the public putting up the money for the flotation either through the medium of an advertised prospectus, or through privately solicited subscriptions. Sometimes, of course, the original vendors of the business are themselves the promoters of the company, but in this case, the whole or part of the purchase price is generally taken in shares, and the fact that the vendors retain an interest in the business suggests that the proposition is a sound one, although it is by no means a complete safeguard. Generally speaking, however, the promoter has no permanent interest in the company he forms, and is more interested in the flotation of the company than in the ultimate success of the business.

It is not for a moment suggested that all company promoters are engaged in the sale of securities at prices greatly in advance of what they subsequently prove to be worth. On the contrary, there are many individuals and firms of excellent standing engaged in this line of business, whose connection with a company is an indication of thoroughly sound finance. It must be admitted, however, that the system is from its nature open to abuse and is responsible for the launching of most of the companies whose shares fall to a discount soon after they have been issued, remain there indefinitely, never yield adequate returns, and sometimes become a total loss.

Direct Appeal to the Public. It is through the medium of direct appeal to the public that the greater part of the capital of English companies is obtained. This is a method particularly suitable for the raising of additional capital by companies already established since the securities of such companies are well known to the Stock Exchange, and they can, moreover, count on a certain measure of support from their own share-

holders. Companies making their own issues are usually advised by a firm of brokers as to the form in which the capital should be raised, and the terms to be offered, and the brokers also arrange for the underwriting of the issue. The method of directly inviting subscriptions from the public, besides being well fitted to the case of companies already established, is also suitable for new companies being formed to take over the manufacture of a well known proprietary article. Where, however, the originators of the company and the goods with which it is to deal are not known to the public, it will probably only be possible to raise capital in this way on expensive terms, and it is in cases such as this that the coöperation of an issue house would be of advantage.

It is the invariable practice both for companies making their own issues and for company promoters to enlist the services of a bank for receiving applications and for carrying through part of the clerical work involved in the issue. The issue houses themselves frequently entrust this work to one of the big banks.

The Investment Trust Company. The companies in this group, which in the aggregate commands a very large volume of capital, are only occasionally concerned in the flotation of new companies. Their method of working is to raise money from the public and to invest it in a variety of securities giving a good income yield, varying their holdings from time to time with a view to increasing their gross receipts. The investor who takes a holding in one of these companies thus has the amount of his stock reinvested in well spread securities giving a favorable return and is relieved of the trouble of making the investment himself, and of the risk of concentrated investment. In other words, he hands over his capital to the directors of the company, and they reinvest it for him to the best advantage in a large number of other securities — a task for which they are well qualified by their superior knowledge of the investment market and the greater combined resources at their disposal. The investment trust companies, although they do not themselves float new companies, are nevertheless concerned in new issues to the extent of applying for large blocks of any issues which they regard as suitable investments, while they also engage in the business of underwriting.

Underwriting. It is customary now for practically all issues

of any importance, however well assured their success may be, to be underwritten. There is naturally very keen competition for this business in connection with the best class of issue or the popular favorite of the moment, and there have been cases recently where issues have been underwritten on terms which were almost certain to show a loss by firms who were evidently anxious to keep in the running for subsequent issues which might prove more profitable. The underwriting is arranged by the issue houses when they themselves are making an issue, and by the brokers to the issue when it is being made by a company promoter or by the company itself. The firm responsible for the underwriting distributes it among a large number of other firms, the issuer paying a commission on the amount underwritten by each firm, and an over-riding commission to the distributing house. The business is thus widely distributed among the various firms, and this is an element of strength as it ensures that in cases where a large proportion of an issue is left with the underwriters it will be well held for gradual disposal, and not thrown on the market in such a way as to cause a break in the price. The firms engaged in underwriting include practically every type of financial house — banks, issue houses, stockbrokers, investment trust companies, and insurance companies, besides private persons.

The Stock Exchange. The market in securities once they have been issued centers on the various stock exchanges, and, above all, on the London Stock Exchange, which deals in a larger number of securities than any other institution in the world. There are in addition to the London market twenty-five other stock exchanges in the chief provincial towns of the United Kingdom, but these are all overshadowed by the London Stock Exchange, which deals with a very much greater volume of transactions, and is also the center of a more extensive international business than any other city can claim.

The London Stock Exchange differs from the other stock exchanges of the world both in its constitution and in its methods of transacting business. It takes the form of a joint stock company, all the shareholders in which must be also members of the Exchange, and is administered by two separate bodies. The shareholders, or proprietors, elect managers who have control of the

premises, fix the amount of admission fees and subscriptions, and appoint officials. The members (all of whom must hold one or more shares) on the other hand elect a Committee for General Purposes which has the power of electing members, and makes and administers the rules for the conduct of business.

Cost of Membership. The cost of becoming a member of the London Stock Exchange is very much less than the amount required in the case of the stock exchanges of some other countries, and this is a feature which is not altogether advantageous to the London Exchange, for it has resulted in the election of a large number of members of comparatively small resources. This arrangement does not give the market the same strength as would result from the existence of a smaller number of members of greater average stability. Such firms would be better able to withstand the selling pressure to which the London market is peculiarly susceptible in times of political or economic difficulty owing to the large amount of international business which it transacts.

The outstanding feature in the organization of the Exchange for the conduct of business is the division of the members into two groups — brokers and jobbers — each having a separate function. The jobbers are the actual dealers in the market. They do business with each other, and with the brokers, but not with the public. The brokers on the other hand do not buy and sell securities as principals, but merely act as intermediaries between the public and the jobbers. The jobbers, being the real dealers, obtain their profit from the difference between the prices at which they buy and sell, while the brokers, being agents for their customers, are remunerated by a commission on the business done. The separation of the functions of brokers and jobbers has undoubtedly contributed to the strength and freedom of the London market. The jobbers, since the brokers relieve them of the trouble of dealing with the public, are free to concentrate the whole of their attention on the market, while this arrangement also gives members of the public the advantage of expert bargaining with the dealer.

"Marking" of Bargains. Facilities are provided for the "marking" of bargains done in the market, but this is not compulsory and the amount of stock dealt in is not shown. The

Committee of the Stock Exchange publishes every day an official list of prices and business done. The latter is compiled from the markings, which do not include all bargains, nor is the sequence of markings necessarily that in which the business has been done. The list is in two parts. The first shows the quoted prices of all securities which have been granted an official quotation, together with the prices at which business has been done. The second or supplementary part of the list shows securities which, although they are allowed to be dealt in, have not an official quotation. In the case of these securities, no quoted prices are shown but only the prices at which business has been done, compiled from markings (which are not compulsory). No security can be dealt in on the Exchange until the permission of the Committee has been obtained.

The Financing of Agriculture. The provision of agricultural credit is a branch of finance which in the United Kingdom has not hitherto received the attention it deserves. This neglect has possibly been due to the fact that agriculture is relatively far less important in British economic organization than in that of other countries. It is, however, generally admitted that the lack of adequate credit facilities has put British agriculture at a great disadvantage as compared with similar undertakings in other countries, and steps are under consideration for developing this branch of British finance on the lines already followed abroad and particularly in the United States of America.

For short-term accommodation, the farmers rely to a large extent on the credit given to them by the tradesmen from whom they buy their stock and implements. In so far as the tradesmen rely on the banks to enable them to allow deferred payment from the farmers, the latter are indirectly using bank credit. A certain amount of short-term accommodation is also granted directly by the banks to farmers. There is, however, in England no satisfactory mechanism whereby farm produce can be made available as security for loans, as is done in the United States of America by means of the chattel mortgage. Consequently, accommodation has to be given either by way of unsecured overdraft, or on the security of title deeds, Stock Exchange investments, or guarantees. Only a small number of farmers, however, are able to give these kinds of security, and the amount of un-

secured overdrafts which the banks feel justified in granting is naturally limited.

Long-Term Credit Provisions. In the provision of long-term credit to agriculture, the United Kingdom is still more backward. The land banks of other countries, which grant loans to farmers for the purchase of land and equipment on the security of a mortgage on their farms, are unknown in England, and the farmers have to rely on mortgages arranged through solicitors, or on loans from the joint stock banks secured on a mortgage of their property. The former method generally makes no definite provision for the gradual reduction of the loan, while advances from the banks are of uncertain duration. The banks, moreover, do not favor this form of loan, as it is contrary to their general principle of liquidity in the employment of their resources.

It is possible that the shortcomings of British finance with regard to both short-term and long-term agricultural credit may in the near future be remedied on the lines suggested in a recent report of the Ministry of Agriculture.[24] For the improvement of short-term credit facilities, it is suggested that arrangements should be introduced for making farm produce available as security for bank loans, by means either of chattel mortgages, or a floating charge on the assets of the farm. In connection with long-term credit, the Report suggests the establishment of a central land bank which would raise money from the public by the issue of debentures, and distribute the funds so raised to the farmers through the medium of the joint stock banks, the debentures being secured on mortgages of the farm. By this means, it is suggested, farmers would be able to obtain loans on mortgage under a uniform system for a definite period of time, and at reasonable rates of interest. The Government is at present investigating the possibilities of the scheme, but no definite announcement of what, if any, steps are to be taken has yet been made.

Savings Banks. In connection with small savings, chief importance attaches to the activities of the Post Office Savings Bank, which was established in 1861 to receive deposits from those sections of the community who do not keep ordinary banking accounts and are not familiar with the channels of invest-

[24] Report on Agricultural Credit — Ministry of Agriculture and Fisheries, 1926.

ment used by people of larger resources. Business is transacted through the Post Office, and interest is paid at the fixed rate of 2½ per cent. The depositors have the direct security of the State, the funds being invested in Government securities or deposited with the Bank of England. There is no limit to the sums which may be deposited, but not more than £500 may be paid into an account in any one year and no person may keep more than one account. The Post Office also undertakes the investment of deposits in Government securities on behalf of depositors if desired. The deposits of the Post Office Savings Bank on the 1st January, 1926, amounted to about £285,000,000.

Trustee Savings Banks. In addition to the Post Office Savings Bank, there are a large number of Trustee Savings Banks which work under regulations imposed by the Trustee Savings Bank Act of 1863. The formation of banks of this type is subject to sanction by the Commissioners for the Reduction of the National Debt. All the assets of the banks must be vested in trustees, and all moneys in excess of the necessary working balances must be paid into the account of the Commissioners with the Bank of England for investment in Government securities, so that depositors in these banks also enjoy the security of the State. The trustees, treasurers, and managers are not allowed to make any profit from the conduct of the banks. No recent figures of deposits in Trustee Savings Banks are available, but the amount involved is probably about £100,000,000.

Small Savings Promoted. A further scheme for small savings was introduced during the war with the double object of encouraging thrift and providing the Government with funds. This was the issue of National Savings Certificates, which seem to have become a permanent medium of investment. Under the terms at present in force, certificates are issued at 16s. each and are repayable to the purchaser after six years at £1 each, and after ten years at £1.4/– each. They may also be encashed at intermediate dates at stated additions to the purchase price. This form of saving has proved very popular, and at the end of June, 1926, the amount remaining to the credit of investors, excluding accrued interest, was £375,797,461. Interest on the certificates is not subject to income tax, but no person may hold more than 500 certificates.

Attention has also been given to the conduct of savings banks by local authorities, and the one experiment actually made in this direction has resulted very satisfactorily. This was in Birmingham, where the Corporation established a Savings Bank under a special Act of Parliament obtained in 1919. Interest is paid on deposits at the rate of 3½ per cent and by 1925 the depositors numbered 167,000 with deposits of about £6,000,000. The conduct of the Bank has not involved any expense to the ratepayers. Various other municipalities have considered steps for setting up banks on similar lines and in 1923 a bill for giving general powers to municipal authorities to conduct savings banks was introduced by certain members of the Labor Party. No legislation was passed, however, and no other municipalities have established banks.

In connection with small savings, mention must also be made of the building societies which work under special legislation contained in the Building Societies Acts 1874 to 1894. These societies mobilize savings, either as deposits, or in the form of subscription shares, and employ their funds in granting loans for the purchase of houses, with provision for repayment by regular instalments over a number of years.

Finally, it should be added that the joint stock banks have in recent years added to the facilities for saving outlined above by accepting any sum from £1 upwards at the ordinary rate of interest for deposits.

CONCLUSION

The outstanding development in English banking during the last ten years has been the series of amalgamations between the big joint stock banks which has resulted in the concentration of the greater part of the banking business of the country in the hands of only five institutions. There can be little doubt that this movement, besides giving strength to the banking system as a whole, has increased the efficiency with which the financial resources of the country are mobilized and made available for industry and commerce. This result, moreover, has been achieved without any sacrifice of the freedom of competition which has always been a characteristic of British banking. Competition is

indeed keener to-day than ever before, and if any complaint were to be made in this connection it would probably be that the rivalry between banks too often results in the opening of new branches for which there is little or no economic justification. The banking facilities available to the public are certainly more complete than they have ever been before, and compare favorably with those of any other country in the world. It is true that the old personal relationship between banker and customer has disappeared with the absorption of the small local banks by larger institutions, and this has perhaps made it more difficult for the small business man to obtain advances, but the more thorough investigations made by the larger institutions before granting accommodation must tend to increase the efficiency of trade and industry, and it is only the unsoundly conducted business which need fear scrutiny.

Question of Further Concentration. To say, however, that the concentration of banking business in the hands of a few large institutions has so far proved beneficial to the public is not to say that this policy could advantageously be pursued any farther, and there are indications that the amalgamation movement has now been carried as far as is compatible with increased efficiency. Apart perhaps from the possibility of amalgamations between members of the Big Five and the three Lancashire banks which still work independently, it is difficult to see what advantages, geographical or administrative, could be derived from further unions. Any proposals for amalgamations between members of the Big Five themselves would arouse justifiable fears of a banking monopoly, against which public opinion would certainly demand protective legislation if the present arrangement, under which amalgamation schemes are by agreement between the Government and the banks subject to Treasury sanction, proved inadequate. The Government has moreover definitely stated that it will not favor further amalgamations between the big banks. That British bankers, whose common sense and integrity have hitherto enabled British banking to be conducted with a freedom from control which is almost unique, would attempt to disregard the public interest by promoting a banking monopoly is highly improbable, and no important changes in the structure of British banking need therefore be anticipated for many years to come.

Nor is there likely to be any marked alteration in the principles underlying the conduct of British banking business, of which the chief is the insistence upon liquidity necessitated by the large proportion of demand liabilities which the banks carry.

An Eventful Decade. For the London money market as a whole no less than for the banks which are its largest constituents, the last decade has been an eventful one. The outstanding feature has been the abandonment of the gold standard, followed by the evils which attend a virtually inconvertible paper currency, and doubts as to whether London could maintain her position as the leading financial center of the world. The consequences of the departure from the recognized principles of orthodox finance demanded by the exigencies of the war were an emphatic proof of the soundness of the system which served England so well in pre-war days, and it is to the restoration as far as possible of the pre-war system that financial policy since the war has been directed. The period of recuperation has been long and difficult, but the determination at all costs to restore the pre-war gold value of the £ sterling has already brought its own reward in the undiminished financial prestige which London now enjoys.

Although the principles of the British monetary system of to-day are those which prevailed before the war, the details of the working of the money market must for many years present problems which did not arise in pre-war days. One of these problems is connected with the magnitude of the Government's operations in the money market. In consequence of the large volume of Government debt, both funded and floating, which was created during the war, the Government has occasion to make periodic disbursements which are sufficiently large in proportion to the total amount of money in the market to cause serious disturbances in the short loan market unless counteracted by open market operations by the Bank of England.

Interest and Inflation. On the 1st June and the 1st December of every year, for instance, the Government is called upon to disburse nearly £50,000,000 in interest on the 5 per cent War Loan. The greater part of this sum, having been paid into their own banks by the people who receive it, becomes bankers' cash at the Bank of England, and as such is a potential basis of a very considerable inflation of bank credit. Any undesirable in-

crease in credit on such occasions, however, can be counteracted by the Bank of England by realizing securities so as to take money off the market, and by the Treasury by the manipulation of the floating debt in such a way as to decrease repayments of short-term loans when there is a plethora of money in the market, and at the same time to borrow more than the usual amount. In this way, the effect of such periodic Government disbursements on bank credit can be minimized, and the success with which the Bank of England and the Treasury have hitherto adapted the Government's financial operations to market conditions suggests that little difficulty in this connection need be feared in the future.

International Coöperation. The restoration of the free gold market has finally dispelled the fears, which at one time seemed only too well founded, that the strain of the war period would leave London's prestige permanently impaired, and the immediate outlook for British finance is more satisfactory now than at any other time since the war. Not least among the encouraging indications for the future is the friendly relationship which has existed since the war between the financial authorities of the United Kingdom and those of the United States of America. The prospect of mutually helpful coöperation between the two leading financial nations in facing the monetary problems of coming years is one which augurs well for the economic progress of the world.

STATISTICAL APPENDIX TO SECTION ON JOINT STOCK BANKS

TABLE I—NUMBER OF INHABITANTS TO EACH BANKING OFFICE

Year	England and Wales			Scotland			Ireland		
	Population [25]	No. of Banking Offices [26]	No. of inhabitants to each Banking Office	Population [25]	No. of Banking Offices [26]	No. of inhabitants to each Banking Office	Population [25]	No. of Banking Offices [26]	No. of inhabitants to each Banking Office
1891	29,002,525	2,338	12,405	4,025,647	982	4,099	4,704,750	464	10,140
1901	32,527,843	3,935	8,266	4,472,103	1,092	4,095	4,458,775	559	7,976
1911	36,070,492	5,419	6,656	4,760,904	1,225	3,886	4,390,219	679	6,466
1921	37,886,699	7,611	4,978	4,882,497	1,308	3,733	4,496,000	947	4,748
1925	38,890,000	8,473	4,590	4,893,032	1,563	3,131	1,279,000 [27]	252 [27]	5,075 [27]

[25] The figures of population for England and Wales, and Scotland, 1891–1921, and Ireland 1891–1911 are taken from census returns. The remainder are estimated figures taken from the Statesman's Year Book.

[26] Taken from the foregoing tables reproduced from the "Economist" Banking Supplement, 29th May, 1926. The numbers of banking offices for 1891 and 1901 are estimated.

[27] These figures are for Northern Ireland, and are for 1924, no estimate of population for 1925 being available.

The figures given in the following table have been extracted from Joseph Sykes's "The Amalgamation Movement in English Banking, 1825–1924." (London, P. S. King & Son Ltd., 1926) by kind permission of the Author.

TABLE II—BANK AMALGAMATIONS
(ENGLAND AND WALES)

Years	Private with Private	Joint Stock absorbs Private	Joint Stock with Joint Stock	Private absorbs Joint Stock	Total
1826–1843	23	93	6	.	122
1844–1861	11	23	10	.	44
1862–1889	31	66	40	1	138
1890–1902	37	64	51	1	153
1903–1924	1	36	58	.	95
	103	282	165	2	552

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RUSSIA

In the present work, which has been written on the basis of various of the writer's Russian books and articles dealing with the same subject, the author has made use of numerous books, articles, reports, etc., including the work of: Lamansky, I. I. Kaufman, Kulomzin, Goldman, Nikolsky, Bezobrazov, Brjesky, Miklashevsky, Kashkarov, Migulin, Preobrazhensky, Sudeikin, Guriev, Yasnopolsky, J. J. Levin, Epstoin, Vanag, Ronin, Sokolnikov, A. N. Zak, Herzenstein, Baturinsky, Heisin, Kosinsky, Zheleznov, Anziferov, and others. The writer, however, does not consider it necessary to quote the list of these works of reference, since they are all in the Russian language. Those who read Russian and are desirous of looking up these references, will find all the necessary data in the author's Russian books, namely " Uchenie o Dengah i Kredite " (Money & Credit),

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